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The Journal of SOCIAL, POLITICAL AND ECONOMIC STUDIES

Roger Pearson
General Editor
Dwight D. Murphey
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Economic Crime in Romania[1]

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At this point, a Romanian company has far more incentives to activate in the shadow economy than it has to operate legally and legitimately. Economic crime is directly related to the lack of economic reforms, the slow peace of privatization, and the weak legal framework. Economic crime in Romania is characterized by the emergence of organized criminal gangs. There are connections within this community that have important impacts on money laundering, terrorist activities, and counterfeiting

Key Words: Romania, Economic Crime, corruption, illegal capital, tax evasion, money laundering, shadow companies, pyramid schemes, smuggling, phreaking, state ownership, privatization.

Economic crime is fostered by and reinforces the shadow economy. During the last decade the shadow economy in Romania has grown to alarming levels fuelled by inflows of illegal capital obtained through a wide variety of schemes and frauds.

Economic crime is directly related to the absence of economic reforms, the slow pace of privatization, and the weak legal framework. The criminals were able to exploit these weaknesses and use the illegal profits obtained in the process to further develop and sustain illegal activities. State corruption has played an important role in such development allowing criminals to often benefit from support and protection from high ranked government or local administration officials.

Illegal Capital

– Capital Obtained Through Illicit Means

After the fall of Communism in 1989, Romania was confronted with the difficult task of building a market economy on the ruins of a centralized economic system in which the capital was entirely owned by the State. In theory, this task was to be accomplished through economic reform and privatization initiated and supervised by the Government, within a clear and well-defined legal frame.

In the early 1990s, in Romania there were few local investors able to purchase the state owned assets and companies. The local investors

[1] The authors want to thank Mr.Razvan Pasol, President of InterCapital Invest, for the useful information about the securities fraud crimes that he kindly and promptly provided them.

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simply lacked the necessary capital.

However, it did not take long until a number of people identified the lack of legal regulations in certain areas – such as banking, commerce, foreign trade, and so on – and started to exploit this vacuum for their own benefit.

For instance, the coexistence of an official (regulated) currency exchange rate on the inter-bank market with a "free market" currency exchange rate represented a golden goose for the speculators who used their personal connections in the state banking system in order to buy cheap dollars on the inter-bank market and then sell them at a premium price on the "free market". Although this kind of operation was illegal and specifically prohibited by law, speculators were able to do it by relying on the corruption of certain officials and on weak law enforcement. These illegal transactions took such a boost that they generated a monetary crisis, which couldn't be solved until the introduction in November 1991 of a single, unified, currency exchange rate whose value was since established by the forces of supply and demand.

The non-existence of a proper legal frame fuelled the explosion of pyramid schemes throughout the country between 1992-1993. Many people attracted by the mirage of earning easy profits took part in such schemes and lost their money while the initiators of these schemes, along with the corrupted officials who supported them, became extremely rich. When the scandal of pyramidal schemes morphed into a socio-economical crisis, the Parliament issued laws and regulations to forbid them. The initiators had to go to court but their trials stretched for years and in many cases they were found not guilty or had to pay little damages and compensations.

During the hot days of the Romanian Revolution millions of people contributed with money deposits to the so-called "Liberty Fund" This fund was hosted in a bank account that was supposed to be administered by the Government and used in order to support the victims of the Revolution. As incredible as it seems, this account has totally vanished and since then none of the officials have offered any relevant information about what happened with the money. A similar situation involved the money in the personal accounts of the former dictator – Nicolae Ceausescu and money in certain accounts of the former secret police – Securitate. Some allege that all this money was embezzled by corrupted officials and former members of the Communist nomenclature.

Using glitches in the institutional and legal frames, personal connections, political influence, bribery or a combination of these,

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certain individuals or companies were able to obtain insufficiently secured or unsecured loans from state banks and later to default on them. This money has almost never been recovered and the persons involved have rarely had to face sentences in court.

All these cases were just a small number of relevant economic crimes through which the illegal capital was accumulated in Romania. We will take a closer look to these economic crimes and describe the main mechanisms behind them later, in the article.

For the time being we'll limit ourselves to say that the illegal capital was further used by its owners to acquire state owned assets and companies through the privatization process.

Due to political reasons, between 1991-1996 the social democrat Government of Romania opted for a mild transition to market economy. While most of the Central and Eastern European countries planned their privatization strategies based on selling the state owned property to foreign investors, the Romanian Government chose to primarily use the Management Employees Buy Out[2] (MEBO) method in the privatization of the state owned companies. In most of the cases domestic investors were preferred to foreign investors. Ironically, at the time, the most important domestic investors were those who secured the illegal capital. Soon this illegal capital would become the foundation of a very profitable shadow economy.

The Shadow Economy in Romania

At the end of year 2000, the Romanian shadow economy was characterized by tax evasion, illegal employment, relationship with the organized crime and terrorism, and involvement in almost all areas of economic crime.

A study prepared by the US Department of Treasury and quoted by Oegar Report[3] indicated that by the end of the year 1999 Romanian shadow economy accounted for 49% of country's Gross Domestic Product (GDP). The same study indicates that should the shadow economy had been kept under control, in 1998 Romania would have had a 3.2% economic growth instead of a 7.3% decline. Most of the shadow economy's proliferation can be traced to a sustained increase in the tax levels after 1997. For instance, between 1993 and 1996 the study indicates that the shadow economy accounted for 5-15% of GDP.

[2] In essence, the method consisted in transferring the ownership of a company from the state to managers and employees by allowing them to buy stock in the company in which they worked.

[3] An Alarming Report: The Underground Economy Represents Half of the Romanian Economy, Oegar Report, http://www.oegar.com/ralar.html

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Starting with 1997 the Romanian Government imposed additional taxes in an attempt to compensate its annual deficit. However, this led to an increase in illegal activities, as noted above.

The following example is a good example of this concept. By 1999, for a net monthly wage of $100 ($130 gross), both the company and the employee had to pay the following taxes:

- the employee:
  - state tax: 15%
  - health care: 7%
  - unemployment fund: 1%
  - retirement fund: 5%
- the company:
  - social security: 30%
  - unemployment fund: 5%
  - health care: 7%
  - Labor Chamber commission: 1%

Therefore, for $100 in wages the combined tax contribution amounted to $92. (Adevarul economic nr. 38(32)/22-28 September 1999)

> Economic Crime – An act in violation of the criminal law that is designed to bring financial gain to the offender *[Nelson.com]*

We can conclude by saying that, by its very own nature, the shadow economy is a perfect environment for the development of economic crime. We note, however, that the shadow economy provides the support, much the same way a bacterial culture provides the perfect conditions for a generalized infection. The economic crime could not proliferate without the influence of certain external factors, a number of which we are discussing below.

Factors that Contributed to the Proliferation of Economic Crime

The Weak Legal Frame

The weak legal frame characterized by incoherent, contradictory or incomplete laws, glitches and inconsistencies was the most important factor that contributed to the proliferation of economic crime. For instance, the Bankruptcy Law was issued by the Parliament in 1995. Between 1990-1995 the creditors of a company had very little legal protection if that company ran out of business.

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The Weak Enforcement of the Law

The state institutions and agencies in charge with the economic crime prevention lacked the material resources, the experience, and the motivation to fight this phenomenon. Faced themselves with corruption, these institutions were very ineffective in enforcing the law. As a consequence, the number of economic crimes increased, as the offenders grew bolder. For instance, the largest warehouse complex in Bucharest was illegally built on public property during the mid 90s. Not only that the owner, Mr. Puzdrea, had no building authorizations whatsoever but also he erected the construction on a major water pipe, fact which was specifically prohibited by law. The Bucharest City Town Hall sued the owner and won in court. Based on the sentence, the Police and other law enforcement agencies made at least three attempts to evacuate the perimeter and level the construction. All of them failed. The owner's connections in the high level circles were too strong for the enforcement agencies.

The Corruption of the Government and Justice

Between 1990-2001 the Romanian press revealed countless cases in which state officials provided favors and services to selected individuals and companies in exchange for bribe or illegal commissions. As far as the government was concerned, bribe was particularly important in the cases related to privatization, assignment of government contracts and issuing export/import licenses. Corrupted judges and magistrates took bribe for not pursuing economic crime charges or for switching sentences for serious offenders into milder ones. Two notorious cases refer to attorneys elected senators and represented famous offenders in court as "simple" barristers.

The Unstructured Bureaucracy

Most of the Romanian bureaucracy is unstructured, a lot of times the standard operating procedures are inexistent or are not applied. This leaves room for discretionary, subjective interpretations by the official employees. In return, this situation creates optimal conditions for corruption. For instance, "Ziarul Financiar" newspaper[4] mentions the case of a local entrepreneur who, in order to get the license for using the water from a nearby river to supply his hotel, had to submit the written consent of the owner of the dam he was using. When he told the authorities that he was the owner of the dam and let them understand

[4] Marinescu, Oana, Interview with Cornel Gaina, President of SIMPATURISM Travel Agency, Ziarul Financiar, September 6, 1999

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that he was unwilling to pay bribe, he was made to write down a paper that he was consenting to allow himself to use the dam.

The Formation of a Political Clientele

Political parties spent huge amounts of money for advertising during their campaigns. The bulk of this money comes from "sponsors" who hope to be rewarded upon the winning of the elections. The reward usually comes in different forms from appointments to jobs in the high hierarchy of the administration to "favors" such as preferential tax treatments for sponsor's company, allocation of government contracts and so on. It is important to note that most cash transactions cannot be traced while the modern instruments of payment provide at least some background checking and transaction tracing opportunities.

Key Government Organizations

In order to correctly understand the economic crime we need to describe a number of government organizations that have played important roles in relationship with this phenomenon.

State Ownership Fund[5]

The State Ownership Fund was created in 1991 as a government agency in charge with the administration and the privatization the state owned companies. A major criticism brought to this agency was that its generously paid employees didn't have any interest to attain its purpose (entirely privatizing the state capital) because the law stipulated that the agency was to be dissolved immediately after the accomplishment of its goal. In fact, between 1991-2001, the State Ownership Fund has privatized only 30%-35% of the total state capital that it administers. This institution had gained a tremendous political and financial power over the years. It soon became a "state in state", an institution that was practically under no control. (see Supreme Court Accounting Court) The State Ownership Fund is *"de facto"* responsible for most of the illegal privatizations in Romania.

Department of Customs

The Department of Customs has been reorganized several times after 1989, but the Romanian press still echoes every now and then various illegalities that happen in the Customs Office, varying from small crooks (i.e. custom officers accepting bribes to allow private persons not to pay custom taxes on personal goods brought from abroad) to larger scale operations.

[5] In December, 2000 the Government dissolved the State Ownership Fund and replaced it with the Romanian Privatization Authority who took over its responsibilities.

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Financial Guard

The Financial Guard was established in 1991 in order to act as a certified auditor and controller for private companies. It is organized based on the same principles as several other similar foreign agencies (most notably the Italian Financial Guard). In time its powers grew and some of the incidents in which the Financial Guard was involved, included:

a) Financial Guard officers who abused their positions in order to benefit themselves or to harass certain companies. For instance, a Financial Guard officer who owns or is a major shareholder in a company can convince his inspection team colleagues to audit his company's competitors, with the sole purpose of finding something wrong in their accounting papers and fine them a huge amount of money. (One must note that the controlling team knows beforehand that they must find something wrong).

b) Financial Guard officers who abused the unclear and contradictory regulations and standard operating procedures. For instance, the regulations that state how the penalties for not paying taxes in due time should be calculated are vague. That allows a Financial Guard officer auditing a firm to use several methods (depending on his own personal interest) to calculate the penalty. Suppose that a company owes $10,000 in taxes to the Government and pays only $9,999, delaying the payment of the last dollar for 3 months. The norms don't explicitly say that the penalty should be calculated only for the remaining unpaid dollar or for the whole amount. Therefore, an Financial Guard officer can compute the penalty owed to the State based on the $10,000 amount. The effect is, of course, a raise in the level of tax evasion. A company in the situation described above has no incentive to pay its taxes entirely, unless it can do it in a single payment of $10.000, because it is going to be penalized on the full amount anyway, rather than the remaining balance. Typically, the company would pay only $1 instead of the $9,999 that they could have spared initially, and use $1,000 to bribe the auditing officer to compute the penalty in a more favorable way.

c) Corrupted high ranked Financial Guard officers working with/for the organized crime. The newspaper "Ziua" has recently published an article[6] about a person from Suceava city who refused to become part of the local mafia. In retaliation, the organized crime using its

[6] "Ziua" newspaper, "Alone against the Mob" by Marius Batca, June 20, 2001.

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connections in the Police and the Financial Guard set him up and had him arrested charged under inexistent offenses.

National Securities Commission

The National Securities Commission (the Romanian acronym is CNVM from Comisia Nationala a Valorilor Mobiliare) was formed at the same time with the Romanian Stock Exchange. Its primary duty has been to watch over any transaction involving securities, as well as to develop some rules for trading. However, due to various reasons including vested interests, lack of adequate training, etc. CNVM has been involved in various scandals (see Securities Fraud).

Prime Minister's Department of Control

The Prime Minister's Department of Control (or DCG, from Departamentul de Control al Guvernului) was formed to act as a prevention and control body in charge with the investigation of illegal activities in which members of the Government or local administration members (mayors and such) might be involved. Since its inception it has uncovered a number of illegalities that have compromised some public figures, even though some of the charges have been (allegedly without strong reasons) dropped.

Supreme Accounting Court

The Supreme Accounting Court is similar to Financial Guard, only that its primary duty is to act as auditor/controller for state owned companies and state institutions (it can audit the Financial Guard, for instance). The main criticism brought to this institution was less related to corruption and more related to its ineffectiveness. Confronted with a tremendous number of economic crime cases, some involving criminals with strong political connections, lacking the expertise and the adequate personnel resources, the audits performed by the Supreme Accounting Court rarely translated into practical consequences for the offenders.

The institution lost a lot of its power and effectiveness when the Romanian Parliament took away its ability to audit the privatizations done by the State Property Fund, an area that was traditionally prone to economic crime.

Main Types of Economic Crime:

Commercial Crime

This type of scheme was mostly used between 1990-1995. The typical mechanism involved at least 3 persons: an "insider" - a loan manager from one of the state-owned banks, a "beneficiary" -a person

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that owned a limited liability corporation and "a sponsor" -politician or high-ranked official that acted as a intermediary between the two. The "beneficiary" was typically a friend or a campaign donor for the "sponsor". In return for his support, or in the name of their friendship, the beneficiary would require the "sponsor" to facilitate a loan between the "insider's" bank and the "beneficiary". Often, both the "sponsor" and the "insider" were promised and then given cuts from the loan. Then, the sponsor would use his influence, political power, connections or official authority to determine the "insider" to grant the loan to the beneficiary under very favorable terms (i.e. long grace periods, without due diligence, without business plans, without or with little collaterals, at a very low and discriminatory interest rate, etc). The insider would use the bank money to grand a loan to beneficiary's limited partnership corporation for financing the purchase of an asset.

In a lot of cases, the loan money was then split among the three parties. In some other cases, part of the loan money was invested in an asset by the beneficiary. This asset was then used as a collateral for a further loan, at a different bank, using pretty much the same scheme. There were cases when the spiral continued for a few more iterations. Most of the loans obtained through such schemes were never returned to the banks that issued the loans. This was possible due to a number of causes:

- As an owner of a limited liability corporation, the beneficiary was only liable to he extent of the equity he owned in the corporation.
- The beneficiary (as a manager and only owner of the company) could cover the misuse of the loan by recording inexistent or grossly over-evaluated purchases of assets.
- The representatives of state authorities in charge with controlling and supervising the banks (i.e. National Bank of Romania, the Supreme Accounting Court, etc) as well as the representatives of the authorities in charge with controlling and supervising the activity of corporations (Economic Crime Police and the Financial Guard) were in many cases corruptible by either bribe or through political pressure from the "sponsor".
- Between 1990-1995 the ruling party had the absolute control of the most state institutions and the illegalities committed by certain members of the party were usually covered up for different reasons (e.g. to avoid public scandal and a decrease in popularity/number of votes)

This type of scheme lasted for some years and what blew it apart was that by 1995 a number of big banks, such as Dacia Felix and Credit

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Bank, went bankrupt. Only then, under the pressure of public opinion (deponents), the investigations revealed the truth. It was the first time the public learned about the truth. In all cases only the insider and the beneficiary had to face trials and most of the times they were given mild sentences. By the end of year 1998, Bancorex – the largest state-owned commercial bank, Banca and Bankcoop, – went bankrupt while Banca Agricola faced serious difficulties. This generated a serious crisis in the Romanian banking system.

As for those who benefited from these schemes, probably the most known case is that of Ilie Alexandru, CEO of "Hermes" a company that produced TV sets among other goods. During 1992-1995 Mr. Alexandru secured funds using the above-mentioned scheme and started using them to his own interest, rather than to benefit his company. He used some of these loans in order to build a huge but unfeasible theme-park ranch, named "Southfork Slobozia" (after the "Dallas" soap opera) in which he also erected small replicas of the Eiffel Tower and Statue of Liberty. The Romanian press coined the term "cardboard billionaires" for these types of persons, the hidden irony being the fact that should the loaned money be asked back, those persons should collapse, together with their small empires, like castles made of playing cards. Mr. Alexandru was placed on trial today for fraud, and all of his possessions auctioned in order to recover part of the loaned money.

The scandals that ensued showed that the main bankruptcy reason was an enormous amount of granted loans that had little chances of recovery. Since then, the National Bank of Romania issued new regulations and the banks have adopted tighter credit policies.

Pyramid Schemes

"...promise consumers or investors large profits based primarily on recruiting others to join their program, not based on profits from any real investment or real sale of goods to the public. Some schemes may purport to sell a product, but they often simply use the product to hide their pyramid structure[7]."

Caritas

In 1992, leveraging on the legal "vacuum", Ioan Stoica established a new limited liability company named "Caritas" that promised whoever deposited his money at Caritas a return eight times his money, in three

[7] Prepared statement of Debra A. Valentine, General Counsel for the U.S. Federal Trade Commission on "Pyramid Schemes" presented at the International Monetary Fund's Seminar on Current Legal Issues Affecting Central Banks, Washington, D.C., May 13, 1998 http://www.ftc.gov/speeches/other/dvimf16.htm

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months. This whole affair was structured as a typical pyramid scheme. What made this phenomenon distinct was its amplitude. Between 1992-1994, 4 million people deposited at Caritas the equivalent of about $820.5 million[8]. This scheme could not have existed without the tacit support of high ranked officials, including names in the Parliament, Government, Police and local administration who "invested" in Caritas and were paid preferentially and substantially, over the line. The same people were the first to recover their money when Caritas crashed in 1994.

The crash threw Romania into a serious social and financial crisis and it turned into a huge political scandal. The trial took 6 years during which, the court had to go through over a ton of complaints from the 256,000 of plaintiffs.

Since 1994 the pyramid schemes were have been banned by law.

Chain of Phantom Companies Schemes

A phantom company is a fictitious company that cannot be hold accountable in a court because it doesn't exist as a "*de jure*" entity.

According to the Law of Commercial Companies, in order to establish a company, the initial investors have to register at the Trade Registrar by presenting a notarized company statute, a notarized copy of investor's IDs, a notarize proof that the company functions at a real address (proof of residency), and a notarized proof that the minimum capital stated by law has been deposited by the investors in the company's account. Based on these documents, the Trade Registrar issues the company a unique Registration Number written on a registration certificate, along with the name of the company and its address. Simultaneously, the company is required by law to obtain a "fiscal code" from the Minister of Finance. Based on this number, the company pays its taxes. A company cannot function without a registration certificate and a fiscal code.

Using various means including false IDs and false proofs of residency, somebody can establish a company that doesn't exist, in order to obtain a certificate of registration and a fiscal code. A "clean" phantom company is an invaluable asset for a group of economic criminals because it can be used in all types of economic crimes without fearing the consequences of the law. When the investigators come to check the books or the activities of a phantom company, they usually

[8] Amount based on the average Romanian leu/US dollar exchange rate between 1992-1994, calculated from values published by the National Bank of Romania (http://www.bnro.ro/), and the total value of the fraud as given by Evenimentul Zilei , February 11, 1999 (http://www.expres.ro/arhive/1999/februarie/11/cotidian/9-1.html).

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find an empty apartment, or an inexistent address, the "owners" prove to be persons that left the country or people that lost or had their IDs stolen, and so on.

A simple scheme involving a phantom company works as follows. A person representing the phantom company would contact another company making arrangements to buy goods from the latter by check. The supplier will issue a fiscal bill for the goods to the phantom company. The representative of the phantom company will pay by corporate check and leave with the goods. By the time supplier is notified about the fact that the check is invalid and the phantom company does not have any money in its account, the goods are long sold on the through other phantom or legitimate companies.

More complicated schemes, involving chains of phantom companies are used in gas, cigarette and alcohol smuggling when the owners of illegally obtained merchandise want to cover its origin.

For example, let's say a group of criminals is specializing in stealing gas from the national gas pipe system. They manage to puncture the pipe, install a pump and fill up a cistern with gas. They cannot sell the gas directly to a gas station, because by law, the gas stations cannot buy from individuals. They can't sell the gas directly to a legitimate company because, again, the companies cannot buy gas from individuals. Therefore they need a phantom company, either that they own it or that they steal for it. This first phantom company will pay them a fraction of the value of the gas and then it will sell the gas to a second phantom company. This can be repeated a number of times until the origin of the gas is totally covered. The stolen gas can even be traded among a few legitimate companies before it's finally sold to a gas station.

Money Laundering

This scheme was in fact very simple and involved two partners: the "loser" and the "winner". While in practice there was no losing or winning, in order for the scheme to work somebody had to appear as losing money and somebody – as winning money. The two partners had to work together and split the laundered money. The loser had money coming from illicit activities (drug dealing, prostitution, smuggling, etc). He couldn't justify their origin. Lets say that Mr. L had $100 of illicit money. He will be the loser. Let's also say Mr. W owns a limited partnership corporation that sells shoes. He will be de winner. Let's further assume that a pair of shoes is normally sold on the market for $5. Mr. W's company would sell a pair of shoes to Mr. L for $100. Mr. L will further sell the shoes on the market for $5 recording a loss of $95. In the same time, Mr.W's company will record revenues of $100. After

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deducting the cost of shoes and paying taxes, he gets to keep, say $70 as net profit. This money is now clean money that can be taken out from Mr. W's company through dividends that he can pay to himself as the owner and single unique shareholder. Finally, as a private person, Mr. W will return the laundered money to Mr. L minus a commission for the laundering.

The same scheme can be employed in casinos, were all the gains are taxable. The loser will lose the dirty money, and then, after a period of time, he will "win" back the same amount, minus the state taxes and the commission for the winner.

Main Types of Economic Crime:

State Statuses and Programs

Tax Evasion: Illegal VAT Recovery from False Exports

This scheme involves an "exporter" and a customs officer. According to the Romanian law, all the goods that are sold on the Romanian territory are subject to a Value Added Tax (VAT) of 19%. This tax is applied the same way the sales tax is applied in the US.

The same law states that goods that are exported from Romania to other countries are exempt from VAT. For example, a Romanian company produces TV sets and prices them at $100. If the company is going to sell a TV in Romania it will have to sell the TV for $119 to accommodate the VAT. However, if they export the TV, they can sell it abroad for $100. The trick is to convince to Romanian authorities the company exports the TV while in fact the TV remains on Romanian territory and is sold at $119. Out of this amount, $100 are declared in the company's ledgers as an export-generated revenue while $19 remain undeclared and represent illicit money.

This scheme cannot work without two essential ingredients: a false "Export Declaration Form" (see forged official documents) and the cooperation of a custom officer that can be obtain through personal relations and/or bribe.

Tax Evasion through False and Misleading Statements in Company's Ledgers (recording inexistent expenses in company's ledgers)

In Romania, the taxable profit of a company is computed by subtracting all the company's expenses from all the company's revenues. If a company wants to decrease its the taxable profit, it can increase its expenses keeping in the same time all other things constant. Many companies evade paying taxes by recording inexistent or inflated expenses in their ledgers.

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A simple tax evasion scheme works as follows. The company buys on the black market a false, blank "fiscal bill" (see official documents forgery). Then it fills in this fiscal bill, as if a supplier issued it. Afterwards, the company records in the ledger an expense equal with the amount it previously put in the bill. At the end of the fiscal period, the revenue is diminished by that expense, leading to a decrease in taxable profit. In such a way, the owners of the company not only that can evade paying profit taxes but they can also cash the expense money out of the company's bank accounts without paying income and social security taxes.

Another form of evasion was the scheme of false "collaboration contracts[9]". Until 1999, the law stated that part-time workers and consultants had to pay lower income taxes than full-time employees. The same law stated that a company does not have to pay social security taxes for these categories of employees. Therefore not only that most of the companies tried to avoid having full time employees and offered employment only under the a "contract of collaboration", but also falsified such contracts to record inexistent "collaborations" in order to decrease their taxable profits.

The Discriminatory System of Tax Exemptions, Holidays, and Rescheduling (Eurodrinks)

"Tick" Companies

A "tick" company is a parasite company that sucks up the resources of a state own company. Usually the "tick" company is owned by the manager or a member (person A) of the board of a state owned company. Person A uses her position to give preferential facilities to the "tick" company in its commercial relationships with the state company.

In a typical scheme, using his influence on the board, person A manages to bring the "tick" company to be a preferred supplier and/or client of the state company. Being in a preferred position, the "tick" company sells raw materials at a ***higher*** price than the market price, thus bringing prejudices to the target company. After the processing is completed, the finished goods will be sold to the same or other "tick" company at a ***lower*** price than market price of the final product, thus bringing another prejudice to the target company. These schemes contributed to a large number of state-owned companies' bankruptcies. The beauty of this scheme is that many managers brought afterwards – either themselves or through intermediaries – the bankrupted

[9] In Romania, a "contract of collaboration" is a temporary work contract between an employer and a part time employee or consultant.

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companies that they had formerly mismanaged at a bargain price, liquidated their assets and pocketed the cash.

Fraudulent Privatization (Contracts)

From the very beginning, one must note this type of economic crime would not be possible without the support of corrupted State Ownership Fund employees and officials responsible for privatizing the state owned companies.

The Law of Privatization states that the privatizations can be done by the State Ownership Fund through one of two methods: public tenders and direct negotiations with selected investors and it clearly states the situations in which the each method can be applied.

While a complete taxonomy of economic crimes related to privatization is beyond the scope of this paper, one can observe that most of these crimes are related to:

1. Illegal tenders (bribery, lack or disregard of due diligences) and
2. "Gray" privatizations through Joint Ventures or Direct Negotiations

Illegal Tenders (bribery, lack or disregard of due diligences)

This scheme involves an investor A and number of corrupted State Ownership Fund officials. The State Ownership Fund organizes a tender in order to sell a company. The bids are submitted by the interested investors in a written form. An insider from the State Ownership Fund committee that organizes the bid, informs investor A about the offers of the other companies. Investor A modifies his offer at the last moment so it match and exceed the other offers. Investor A wins and becomes the owner of the company. He immediately starts selling its assets, borrowing money from banks (see Obtaining credits secured with collaterals subject to previous commitments) and using "tick" company schemes. He never abides to the contractual terms that he specified in his offer. After a period of time (usually years) the State Ownership Fund formally takes note of the fact that investor A has not completed his obligations and revokes the privatization contract. Meanwhile, most of the assets of the company no longer exist, and the company is in a worse financial condition that it was before its privatization. The amount of money that the investor loses from his initial deposit/investment and from the foreclosure of the guarantees is far exceeded by the illegal profits that he makes using this scheme.

As far as the State Ownership Fund employees are concerned, their offences relate to accepting bribe, failing to pursue the due diligences, and the background and solvability checks on the potential investors,

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breaking the laws, and regulations and procedures concerning the privatization tenders and so on.

"Gray" privatizations through Joint Ventures or Direct Negotiations

The parties involved in joint venture privatization scheme are the same that above. The difference consists in the fact that the investor forms a joint venture with the State Ownership Fund (or, in certain cases, with the local administration) in which the former brings an insignificant amount of equity capital and the later brings a company or major assets. The key of this scheme is a clause in the joint venture contract stating that a partner has preemption rights in the event the other partner decides to sell its shares. Usually the contract stipulates that the preemption rights can be exerted at a price far below the actual market price of the shares. After the joint venture is established all the investor needs to do is to "convince" the State Ownership Fund to sell its shares.

While this scheme is not illegal *per se*, considering that it is used to preferentially privatize a company that otherwise should have been sold through a public tender, it constitutes a "gray" privatization.

As we mentioned before, the law permits the privatization through direct negotiations with a pre-selected investor. However, the law specifically states the circumstances in which this form of privatization can be employed. Despite of that, there were cases in which state company were discretionary and preferentially privatized through this method in complete disregard of the legal prescriptions, therefore breaking not only the Privatization Law but also the spirit of the Romanian Commercial Code.

Smuggling

The three most important products that are subject to smuggling and illegal traffic are cigarettes, alcohol and illicit drugs. These products are brought into the country by smugglers that leverage on the ineffectiveness and lack of experience of the custom officers, from their propensity to corruption and lack of modern technological resources. Romanian press often related that smugglers use automatic weapons, the latest generation of radio and wireless communication, state-of-the-art tracking devices, expensive and powerful cars and boats, while the police and the custom officers often relay on scarce or rudimentary resources.

Over the last decade there were many important cases of smuggling. The most interesting were those that involved state officials. Here are two examples:

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Operation "Jimbolia" is a case in which a Romanian company violated the embargo imposed against Yugoslavia by exporting oil and oil products to Yugoslavia allegedly with the full knowledge and support from the Romanian Government and Romanian Information Service (SRI). The case is still in the court.

Operation "Cigarette" was in fact a series of operations in which cigarettes were smuggled in Romania. In one of using military facilities with the support of high hierarchy officials, including police, customs, and secret service (Serviciul de Paza si Protectie - SPP) officers, local administration officials, Financial Guard officers and so on. In one of these operations, an airplane secretly landed on the Air Force section of the Bucharest-Otopeni Airport in order to avoid the customs. The landing was approved by the commander of the air base, and the whole operation was coordinated by a SPP officer.

Voluntary Mismanagement

Illegal/Preferential/Discriminatory Bank Loans and Credits

These schemes are connected to the collateral schemes explained above (see Illegal loans and "tick" companies). They usually involve power abuses and/or political pressures. Under these schemes a person that works in a bank and has deciding power (VP or chief position) strikes a deal with somebody that does not have the financial power to secure a loan though the normal procedures, and promises a "cut" to the loan officer. The business is made and the money is paid in cash after the loan is secured. The most known cases are probably those of Gabriel Bivolaru – a senator of the ruling party and his wife Mona de Freitas. In the mid-nineties they obtained several loans using these schemes. Mr. Bivolaru never stood trial because he benefited from the parliamentary immunity. His wife left Romania and got her residence in the UK. At the present time, all of their British possessions (properties and bank accounts) have been seized and the authorities are waiting for their Romanian counterparts to start the investigations.

Embezzlement

During the last decade there was an uncountable number of embezzlement cases involving managers of state companies and banks, members of the local administration, members of the Government, and other state employees. All these people used a tremendous variety of methods. Unfortunately, only a few of these criminals were brought in court and even fewer were found guilty due to the traffic of influence between the politicians, the interference of politicians in the justice, corruption and so on.

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Debt Collection Schemes

After the financial crisis generated by "Bancorex" and "Agricola" banks in 1998, the Government decided to create the Asset Recovery Agency (Agentia de Valorificare a Activelor Bancare -AVAB). The role of this agency was to recover the money these banks lend to private companies before going out of business. One method employed by AVAB in order to recover these assets was to sell them at a discount to companies that would foreclose them and cash the money from the actual debtors.

One big scandal related to the activity of AVAB was revealed by the Romanian mass media when a debtor of Bancorex bought from AVAB the recover his debt to Bankorex (from himself), at a very big discount.

Main Types of Economic Crime:

Technological Crime

Internet Related Crimes: "Carding"

"Carding" is a term used to designate credit card fraud associated to purchases on the Internet. These criminals call themselves "carders" and take pride in the number and the quality of merchandise they can acquire fraudulently. There are literarily thousands of websites on the Internet that provide ample documentation, software and even online assistance on "carding". The idea behind carding is to find:

1. A functional credit card and
2. An e-commerce website with a vulnerable credit card authentication system that can deliver merchandise to Romania.

A functional credit card can be obtained in a various number of ways:

- **Hacking into an online database with credit cards**. Typically, the hacker will try to find and attack an adult website with a vulnerable online transaction database. Once accessing the database, he will download it on his own computer. That will give him the credit card numbers, names and billing addresses of all the website customers. Afterwards, he can use this information both for carding and (less typically) for black mail.
- **Using a credit card number generator**. A credit card number generator ("CC generator") is a program that uses mathematical algorithms to "guess" a credit card number. CC generators are free and easily available for download on the Internet. Some of these programs are very versatile being capable of generating up to 20-25% valid credit card numbers. Because of its ease of use,

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this way of carding was very popular until 1998 when most of the e-commerce companies included supplementary authentication measures such as the automated billing address/credit card number match check.

- **Buying a credit number and information from somebody else.** In Romania there were cases in which some dishonest cashiers or waiters allegedly sold credit card information to carders. Carders also trade credit card numbers online, through email, chat channels, and in many other ways.
- **False or bogus e-shops.** A carder can design a website is if it belongs to a legitimate e-commerce company, or can copy the website of such an existing company and put it on his server. The purpose of this scheme is to trick people into ordering goods from the false online shop and thus to obtain their credit card information.

Although finding a suitable e-commerce website has become more and more challenging because of the increased security measures the e-companies have introduced during the last 5 years, carding has flourished. An explanation is that, in the same time, the methods employed by the carders became more and more sophisticated. The lack of legislation concerning the online transactions has nurtured the Romanian Internet related crime to the point where most of the big e-commerce companies ceased to make any deliveries to Romania. However, with the boom of the online commerce at the end of the last decade, a growing number of small companies went online and many of them lacked the computer security experience and training to protect themselves against carders.

The typical Romanian carder is between 15 and 32 years old, has a personal computers and strong knowledge of IT. The experienced carders do not use their personal computers directly because they claim that the dial-up connections on the digital lines are easy to track. Many carders operate from Internet cafés or from home but using stolen dial-up accounts and pirated phone lines. They prefer to place many small sized orders in different places rather than one big order with a single company, in order to increase their chances. Sometimes carders pay other people (usually very old senior citizens) to use their addresses as drop off addresses for the goods they order on the Internet. These persons are usually naïve and have no idea that the merchandise they receive is stolen.

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After they get the goods, carders keep for themselves only what they need and sell the rest through classifieds or through stolen goods retailers.

The authors believe that between 1997 and 1999, on the average, a Romanian carder made between 8 and 7 thousand dollars a year from proceedings on Internet stolen merchandise.

Phreaking

"Phreaking" is a general term used to designate the telephone related crime. This kind of crime has two aspects: a virtual, intangible aspect that derives from the usage of the Internet pc-to-phone and calling card services, and a physical aspect related to phone line piracy.

It is very important to mention that while the physical aspect of phreaking affects primarily the Romanian telephone company – Romtelecom, the virtual aspect affects almost exclusively the foreign long distance carriers and Internet phone companies because the phreaked calling cards are used to make international pc-to-phone calls.

As in the case of carding, there are huge numbers of websites with resources for phreakers. Their *modus operandi* is very similar to those of carders. As in the first case, there are calling card authentication number generators available for download, online forums and chat channels available for support and information, a market (although quite small) for phreaked calling cards.

As far as the physical aspect of phreaking is concerned, before the implementation of digital telephony servers in Romania, a number of people (especially carders) used devices called "boxes" in order to pirate the phone lines. The most popular "boxes" used to derive phone line connections from other people's apartments, boxes used to alter the phone signals or lines in order to avoid the charges for outgoing calls, and boxes used to prevent an incoming call to be charged by the phone company.

Warez

"Warez" is a term used in conjunction with software piracy over the Internet. "Cracking" is a term that designates the procedure through which the protection code of commercial software is removed thus, making it usable to anyone for free. A great number of websites have well diversified cracked programs and cracking software available for download along with lists of serial numbers, serial number generators.

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Since 77 to 80%[10] of the Romanian software market represents pirated software, the importance of "warez" appears in a greater perspective.

Based on the usage of warez, the pirates can be divided into two categories:

- Private pirates are computer users that go on the Internet from home, usually on dial-up connections and use warez for their own needs. They download cracked programs, especially games that they use on their personal computers.
- Commercial pirates are people that have fast connections and download a huge number of cracked programs from the Internet, compile software collections, burn hundreds of CD-s and sell them on the market. (see also copyright infringements)

Main Types of Economic Crime:

Document Fraud Crimes

Official Documents Forgery

One of the most widely available forged official documents in Romania is the so-called "fiscal bill". In Romania, the companies cannot print their own bills. According to the law each company buys registered blank bill-books from office supply stores licensed by the Minister of Finance. Each bill-book has a unique identification number, and each bill in the bill-books has a unique number as well. These are called "fiscal bills". When a company sells goods to other company, it has to take such a fiscal bill, print on it the quantity, the description of the merchandise, the price of goods and the VAT paid by the buyer. The bill needs to be sealed with the company's seal before it's sent or given to the customer.

There are complex networks of criminals that design, print, and distribute the forged "fiscal bills". These networks are very well organized and consist of specialized persons with well-defined roles. There are people that establish companies (see phantom companies schemes) for the sole purpose of obtaining a company seal that can be used in forging a fiscal bill. Another category of people copy or emulate the identification numbers on actual fiscal bills in order to make the forged documents more credible; they can also have attributions related to the design and printing of such documents. A third category (especially old women and children) takes care of the distribution. Usually one can buy forged documents on the highway exits at the suburbs of big towns, from women and children that flash the false bill-

[10] Sixth Annual BSA Global Software Piracy Study, Business Software Alliance, http://www.bsa.org/resources/2001-05-21.55.pdf

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books to drivers. A fourth category of people involved in such networks is "the security people". They are stay in cars parked on the side of the road and supervise the distributors, alerting them immediately when the police shows up.

Another category of forged official documents includes state registration numbers[11], fiscal codes[12], fiscal stamps for tobacco and beverages (see smuggling), company check-books, export declaration forms, sanitary and health compliance certificates, company seals, etc. The third category is made of forged IDs such as: ID cards, passports, work ID-s, bachelors' diplomas, etc.

Counterfeiting

Most of the counterfeiting cases uncovered by police and reported by media involved "primitive" counterfeiting methods such as color-scanning a bill and printing the image on regular paper. A typical network involved in counterfeiting includes the designers that scan and print the bills and the distributors that buy the counterfeited bills usually at half or a third of their face value and try to place it on the market in exchange for real goods or money.

Copyright Infringements

While there are a lot of copyright infringements in the publishing industry, most of these offences come from the software and music industry. According to Business Software Alliance[13], between 1995-2000, the software piracy rates in Romania decreased from 93% to 77%. The effect of this decrease can be attributable to the introduction of the Copyright Law in 1996, the activity of some Romanian anti-piracy organizations and businesses such as, Business Software Alliance, Romanian (ORDA), Microsoft Romania, etc. However, in spite of this decrease, the Romanian piracy rate is still very high, placing Romania among the top four countries in Eastern Europe from this point of view, next to Bulgaria, Russia and Ukraine.

The market for pirated software is concentrated on two main categories:

- Operating systems and professional software;
- Games

The most pirated programs include: Microsoft Windows 95, 98, Me, NT and 2000, Microsoft Office, and Adobe Photoshop. However,

[11] See phantom companies

[12] See phantom companies

[13] Sixth Annual BSA Global Software Piracy Study, Business Software Alliance, http://www.bsa.org/resources/2001-05-21.55.pdf

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virtually all the software titles are available on the black market. There are merchants that sell pirated software on the streets. Some of them give their customers their telephone numbers so they can order custom compilations of software programs. A typical compilation CD entitled, say, "Graphic Software" can contain for instance Adobe Photoshop, Adobe Go Live, Bryce, 3D StudioMax, Corel Draw, Macromedia Fireworks, and many, many other programs. The price of such a compilation CD is between 80-100.000 Romanian lei (about $2.50 - $3.00). To get a true dimension of this phenomenon, one should think that Adobe Photoshop 6.0 alone has a listed price of $609.00[14].

There are three main ways through which the commercial pirates obtain the pirated software:

- Imports (mostly from Ukraine, Bulgaria and Russia) 60%[15]
- Internet 15-20%[16]
- Local cracking (also see Warez).

These commercial pirates have modern multiplication capacities (multiple computers with CD-burners, or professional CD-burning installations) in their apartments, but the size of these capacities is still less than a plant. Software pirates also have large distribution networks and connections within the police. Usually, police patrols close their eyes to pirated software merchants in exchange for bribe. Every now and then, police raids these merchants and fines them, but this is extremely ineffective, especially when you think about the huge profits made by commercial pirates.

Music and video piracy in Romania is usually done using the same scenario as in the case of software piracy, and many times, the same merchants that sell pirated software sell pirated music and videos as well.

Another type of copyright infringement relates to cable television and cable piracy. This is done either by consumers of such services using home-made decoders for pay-per-view channels such as HBO, or by cable-operators that retransmit satellite programs and broadcasts intended for other countries in Western Europe without paying royalties.

According to International Intellectual Property Alliance, "The MPA[17] reports that annual losses to the U.S. motion picture industry

[14] http://www.adobe.com

[15] International Intellectual Property Alliance: 2000 Special 301 Report – Romania: http://www.iipa.com/rbc/2000/ROMANIA_2000.PDF

[16] idem.

[17] Motion Picture Association

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due to audiovisual piracy in Romania are estimated to be US$6 million in 1999."

Main Types of Economic Crime:

Securities Fraud

Insider Trading and Other Security Related Offenses

SAFI-FMOA 1996 (Mutual Fund for Business People administered by SAFI Invest) was a major scandal in 1996 because it employed several illegal business policies, such as including in the present value of the fund uncertain future cash flows from other activities. The result was a disproportionate increase in the market value of the fund and the attraction of thousands of investors. When CNVM (the Romanian equivalent of SEC) recalculated the real present value of SAFI, the fund crashed and a large number of investors lost their money. Some of the blame can be traced to CNVM due to its ineffective supervising policy, as well as to the fund manager for its shady methods of management. Presently, the fund is reorganized as an open fund; however its present market value is a tiny fraction of what it was in 1996. There were almost 200.000 people affected by this crash, people that invested more than 170 million dollars in the fund.

FNI/FNA 2000 (National Investment Fund/National Accumulation Fund) – The funds, just like SAFI, reported fictive asset increases; the difference however was that the money attracted from investors were pulled out and pocketed by the fund managers and certain third parties associated with them. When the scheme was uncovered, there weren't any money left in the fund's bank account and the database containing the list of all the investors was missing. Again, the blame is to be divided between CNVM who did not supervise strictly the fund's activity, and the managers who organized the con scheme. In this case there were over 300.000 affected by the crash.

"Albina" Bank, 1999 – biased management policies as well as disregard for any bank prudence rule. The bank used the deposits to give risky credits to a number of companies whose managers had ties with the bank's Board. Obviously, the bank filed for bankruptcy, since the credits were never recovered. The investors received small compensatory amounts. Beside the management, some of the blame can also be traced to the National Bank of Romania for ineffective supervising.

Mass Privatization Process 1995-present – Legally, the only way to sell the coupons (shares) given to everybody is through a brokerage institution. However there were numerous cases in which certain persons acquired those coupons directly from the population at a price

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below the market value and then sold them to the brokerage institutions at a higher price, thus pocketing the difference. The operation existed on a large scale and it is still practiced.

Insider information based trading – It is worth mentioning that virtually all the transactions on Rasdaq[18] are based on inside information, since the amount of the information publicly available is close to zero. The information held privately, such as knowing that the equity can be positively re-evaluated and as such some equity will be offered for free, can be speculated by buying stock at low prices, prior to the public announcement (which will lead to an increase in the stock price).

Money Laundering

There are several ways to accomplish this: for instance, a person buys penny stocks as an individual and then sells them at a ridiculously higher price to his own company. Thus, the funds are transferred from the company to the person. Similarly, the same game can be played on the futures market, when a party wins and the other party deliberately loses the contract so that the funds are again transferred. (see Money Laundering as a commercial crime)

Connections with the Government

The role of corrupted state officials and employees in the accumulation of illegal capital is tremendous, especially in relationship with the crimes against state statuses and programs. A significant number of government employees are directly involved in crimes related to illegal privatizations, mismanagement, "tick" company schemes, illegal bank loans or indirectly involved in the economic crime by failing to accomplish their mission and duties, by abusing their functions and facilitating the crime.

Connections with the Organized Crime

Over the last decade, the local mobs have flourished over the Romanian territory. They are organized around local barons – rich and powerful people that accumulated their wealth through illegal means. These barons use their resources increase their illegal capital by obtaining the support of key government and local administration employees, fighting the competition and protecting themselves from the enforcement of the law.

[18] The Romanian Securities Exchange

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The organized crime conducts business by its own rules. If a competitor or a debtor does not comply or payback his debt, he faces threats, enforcers, set-ups, and even gun or bomb attacks.

Connections with Terrorism

There are no reports of terrorist activities on the Romanian territory. However, the "Ziua" newspaper uncovered a case[19] in which a Romanian drug company – Sintofarm SA purchases an illegal quantity of a substance (acetic anhydride) that can be used both in the production of aspirin and the production of heroin. The company illegally sold the substance on the black market, through a number of "tick" companies and allegedly benefited from the protection of high ranked police officers. The same newspaper related in a pervious and related article[20] that in 1998, 20 tons of acetic anhydride were illegally exported to Albania by two companies involved in the "Sintofarm" scandal.

According to the CIA World Fact Book[21], Albania is an "increasingly active transhipment point" for drugs heading to Western Europe

There are speculations that the Kosovo Liberation Army and the Albanian guerillas fighting in Macedonia are financed with drug money.

Conclusion

In Romania, the total of major thefts during the last decade amounted to seven billion dollars[22], a figure as big as the total public debt of the country. At this point, a Romanian company has far more incentives to activate in the shadow economy than it has to operate legally and legitimately

Economic crime is directly related to the lack of economic reforms, the slow peace of privatization, and the weak legal framework. The legal framework needs to be improved and updated in order to cover the whole spectrum of economic crimes while the shadow economy should be discouraged. This can be achieved by building an efficient and

[19] "The SINTOFARM Algorithm" by Adina Anghelescu and Petre Niteanu, "Ziua", March 24, 2001:
http://www.ziua.ro/search.php3?class=2001&id=17136&kword=Sintofarm&style=3

[20] "Yet Other 20 tons of Acetic Anhydride Illegally Exported" by Mariana Gavrila, "Ziua", March 17, 2001:
http://www.ziua.ro/search.php3?class=2001&id=15552&kword=Albania&style=3

[21] http://www.cia.gov/cia/publications/factbook/geos/al.html

[22] "Over $7 Billion Worth Of Scams" by Carmen Rudni_chi, Adriana Halpert, "Capital", May 31, 2001:
http://www.capital.ro/arhiva.php?IdOfMagazine=112&IdOfSection=8&MagazineID=95&ViewMagazine=detail&IdOfArticle=3209&ViewArticle=detail

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healthy economy based on the implementation of the economic reforms, a better enforcement of the law, better fiscal and regulatory conditions for the legitimate business, etc. The Government should continue to fight against corruption using more effective means.

The lack or the delay of serious efforts to confine and reduce the economic crime and the size of the shadow economy can seriously jeopardize Romania's plans to join NATO and the European Union.

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Business as Usual: Corruption and Business Activity

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A regression analysis is used to verify the determinants of corruption. Using a cross-sectional data set of 48 countries, a significant relationship between GDP per capita and the level of corruption is confirmed. However, it is likely that GDP per capita is a determinant of corruption and affected by corruption. An instrumental variable technique is used to help determine the true impact of GDP per capita on corruption.

Key Words: GDP per Capita, Transparency International, corruption, freedom, government interference, bureaucracy,

I. Introduction

Corruption - what causes it, its costs, and remedies - is a major concern in international business today. Corruption has been blamed for underdevelopment in some countries and a lack of foreign investment in others. Corruption is the result of too much government interference in the economy, or not enough government oversight. Corruption stems from a lack of competition according to some analysts, while others highlight cultural factors, and still others focus on low wages among bureaucrats.

Remedies to fight corruption run the gamut from promoting development and competition to invoking stiffer penalties for the individuals involved (Klitgaard, 2000).

All of this points to a multi-faceted problem with entangled causes. A better understanding of the causes of corruption would help in the design of policies to overcome it. For instance, if corruption is found to be primarily the result of badly functioning large bureaucracies, then attention could be devoted to improving the functionality of national and business institutions.

On the other hand, if corruption is rampant primarily in economies where governmental restrictions are prevalent, then an opening up of the economy to competition and a reduction in regulation will help.

The reasons why corruption is prevalent in some countries are not well understood. Consider the theory that governments that are heavily involved in their economies, whether it is redistributing income or granting licenses for foreign trade, promote corruption. The idea certainly has intuitive appeal and some anecdotal evidence stands

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behind it. Vietnam and India have relatively high rates of government interference in economic matters and both have high levels of corruption. But Demark, Norway, and Finland have very high levels of government intrusion in their economies and some of the lowest levels of corruption in the world.

II. Measuring Corruption

The standard definition of corruption comes from Nye (1967, pg. 966): "Corruption is behavior which deviates from the formal duties of a public role because of private-regarding (personal, close family, private clique) pecuniary or status gains; or violates rules against the exercise of certain types of private-regarding influence." This broad definition allows for most forms of corruption - bribery, coercion, kickbacks, protection, and other illegal forms of business and politics.

In 1995 Transparency International, an organization "dedicated to curbing both international and national corruption", began releasing its annual Corruption Perceptions Index (CPI). The CPI is an index of indexes in that it combines various surveys and measures of corruption into a single number based on a scale from 0 to 10. The 1999 CPI covers 99 countries and includes data from the following sources:

- Freedom House Nations in Transit
- Gallup International
- The Economist Intelligence Unit
- The Institute for Management Development, Lausanne
- The International Crime Victim Survey
- The Political and Economic Risk Consultancy, Hong Kong
- The Wall Street Journal, Central European Economic Review
- The World Bank and University of Basel
- The World Economic Forum

A detailed methodology of the CPI is available at Transparency International's website (www.transparency.de/). Transparency International's measure of corruption corresponds to Nye's classic definition.

Denmark scores highest in the 1999 version of the CPI as it did in 1998. The CPI indicates that there is virtually no corruption in Denmark. Several Scandinavian countries are in the top 10. Cameroon ranks dead last as the nation with the most corruption in 1999. Many African countries appear at the bottom of the rankings.

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III. The Determinants of Corruption

The goal of this paper is to delineate the factors affecting a nation's CPI score. A review of the empirical research in this regard is summarized in Lambsdorff (1999). Previous investigations have considered

- GDP or Business Activity
- Government Involvement
- Institutional Quality
- Lack of Competition
- Poverty and Inequality
- Wages and Salaries
- Cultural Factors
- Natural Resource Abundance
- Trading Partners
- Demographic Factors

Notice that this list of determinants is only a list of major categories. For instance, under Cultural Factors, researchers have considered variables as disparate as a nation's colonial heritage contributing to corruption (Swamy et al., 1999), as well as hierarchical forms of religion (La Porta et al., 1997).

The empirical investigation undertaken in this paper considered the following set of particular variables as possible determinants of a given nation's level of corruption:

- GDP per capita
- Index of Economic Freedom of The Heritage Foundation
- Number of military personnel per 1000 persons
- Percent of the population over 65 years of age
- Population per square mile
- Year of independence
- Energy consumption per capita
- Output per unit of energy consumed
- A dummy variable equal to 1 if a nation trades heavily with Belgium, France, Italy, Netherlands, or South Korea (These nations have a reputation for readily offering bribes.)

Economic freedom is measured with an index compiled by The Heritage Foundation. It measures how well a nation scores on a list of 50 independent variables that have been divided into 10 broad factors of economic freedom. The 10 factors are:

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- Trade policy
- Fiscal burden of government
- Government intervention in the economy
- Monetary policy
- Capital flows and foreign investment
- Banking
- Wages and prices
- Property rights
- Regulation
- Black market

A complete methodology of the Index of Economic Freedom of The Heritage Foundation is available on the internet at http://www.heritage.org/index/execsum.html

Only the first two proposed determinants of corruption, GDP per capita and economic freedom, are statistically significant at the 5 percent critical level in a set of regressions encompassing 48 countries. (The complete data set appears as an appendix to this paper.) A typical result is:

$$CORPT_i = \underset{(11.3)^*}{9.37} - \underset{(-4.4)^*}{0.000169\ GDP_i} - \underset{(-2.1)^*}{1.05\ FREE_i} - \underset{(-0.21)}{0.005\ MILI_i}$$

t-ratios ; $R^2 = .75$

Where CORPTi is the level of corruption of the ith nation
GDPi is GDP per capita
FREEi is the index of economic freedom
MILIi is the number of military personnel per 1000 persons

* indicates significance at the 5 percent critical level

This result is typical in that once GDP and FREE are included as explanatory variables, none of the other explanatory variables listed is significant when added to the regression. Notice that the first two explanatory variables attain their expected signs. GDP has a negative coefficient indicating that countries with higher GDP per capita generally will have lower levels of corruption. FREE also has a negative coefficient. This implies that countries that are more open to international trade, with less government interference in the economy, fewer regulations, and more clearly defined property rights have less

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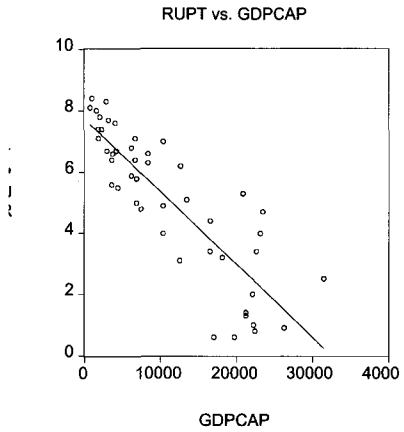
corruption. MILI has a negative coefficient when a positive relationship is expected, but the coefficient is not statistically significant.

Later we will use the result that population per square mile (POP) and percent of the population over 65 years old (SIXTY5) are not significant determinants of corruption:

$$\begin{array}{lll} CORPT_i = & 9.34 - 0.000170\ GDP_i - 1.05\ FREE_i + 0.000002\ POP_i & \\ & (11.4)^* \quad (-4.4)^* \quad (-2.1)^* \quad (0.02) & \text{t-ratios ; } R^2 = .75 \end{array}$$

$$\begin{array}{lll} CORPT_i = & 9.62 - 0.000153\ GDP_i - 1.13\ FREE_i - 0.029\ SIXTY5_i & \\ & (10.4)^* \quad (-3.3)^* \quad (-2.2)^* \quad (-0.62) & \text{t-ratios ; } R^2 = .76 \end{array}$$

The conclusion to be drawn from these preliminary regressions is that GDP per capita and economic freedom are the primary determinants of corruption. Scattergrams bolster the conclusion.



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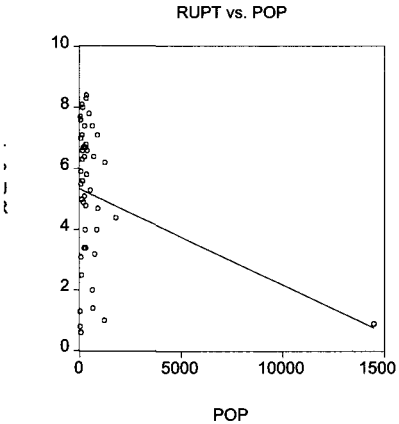
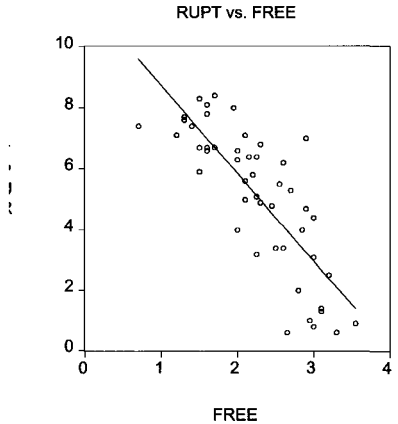
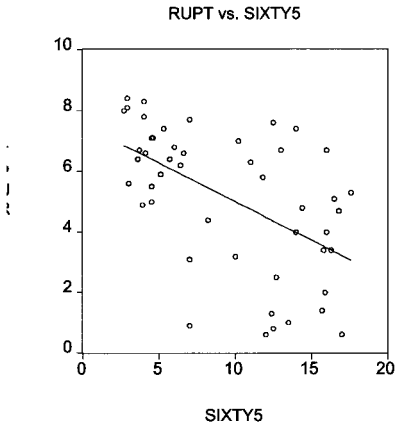
Scattergrams also verify that population per square mile (POP) and percent of the population over 65 years old (SIXTY5) are not related to the level of corruption.





Singapore is the outlier in scattergram of POP on RUPT. Even without it, there is no relationship between POP and RUPT since the regression line would be almost vertical.

The scattergram of SIXTY5 on RUPT has a negative slope, but the relationship is not statistically significant.



The conclusion that GDP per capita and economic freedom are the primary determinants of the level of corruption must be tempered because the of the econometric deficiencies of the regressions above.

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IV. Simultaneity Bias

The regressions used to draw the conclusion that GDP per capita and economic freedom are the primary determinants of the level of corruption suffer from simultaneity bias. Specifically, GDP per capita is used to explain the level of corruption, but the level of corruption across nations affects their GDP per capita. In other words, the regressions suffer from reverse causality.

Indeed, it is only hearty intuition that suggests GDP per capita will affect corruption. The reasoning is that poor nations will not have the resources to fight corruption, or their citizens will be forced to resort to corruption to survive. Whereas the idea that corruption affects GDP has a vast economic literature behind it. The notion that corruption is a form of rent-seeking that wastes resources and therefore lowers GDP goes back to the 1960s. Krueger's (1974) paper is an especially elegant theoretical exposition of the welfare loss from rent-seeking.

Notice that there is likely to be a simultaneous relationship between economic freedom and corruption as well. The measure of economic freedom includes information on the degree of government regulation and intervention, capital flows, and trade policies that are likely to affect the level of corruption.

When the dependent variable in a regression feeds back onto an independent variable, ordinary least-squares estimates of the structural parameters are biased. Instrumental variables or two-stage least-squares are techniques designed to overcome simultaneity bias.

The basic idea behind instrumental variables is to replace the tainted independent variable with another variable that is highly correlated with it, but is not impacted by the feedback from the dependent variable. Two-stage least-squares creates the variable to be used as an instrument in the first stage and then applies ordinary least-squares using the instrument in the second stage.

In this specific case, a good instrument for GDP per capita will be highly correlated with GDP per capita but not with corruption. We know from our investigation that population per square mile (POP) and percent of the population over 65 years old (SIXTY5) are not related to the level of corruption. However, each of these variables is correlated with GDP per capita. A regression of both on GDP per capita yields:

$$\begin{array}{lll} GDP_i = & -348.56 + 1.40\,POP_i + 1094.31\,SIXTY5_i & \\ & (-0.2) \quad (3.3)^* \quad (6.3)^* & \leftarrow \text{t-ratios};\ R^2 = .52 \end{array}$$

Population per square mile (POP) and percent of the population over 65 years old (SIXTY5) will also serve as good instruments for

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economic freedom. Again, both are not related to corruption, but a regression indicates that they are correlated with economic freedom:

$$\begin{array}{lll} FREE_i = & 1.64 + 0.000108\ POP_i + 0.06\ SIXTY5_i & \\ & (9.2)^* \quad (2.7)^* \quad (3.5)^* \qquad \text{t-ratios ; } R^2 = .29 \end{array}$$

The predicted values of GDP and FREE from these two regressions are used as the instruments for the actual values of GDP and FREE in the second stage of two-stage least squares. The second stage regression yields:

$$\begin{array}{lll} CORPT_i = & 8.53 - 0.000214\ GDP_i - 0.47\ FREE_i & \\ & (2.0) \quad (-1.4) \quad (-0.2) \qquad \text{t-ratios ; } R^2 = .75 \end{array}$$

Neither GDP per capita or economic freedom is statistically significant in the second stage regression. The constant term has the highest t-ratio and is almost statistically significant at the 5 percent critical level. The regression suggests that GDP per capita and economic freedom are not determinants of corruption.

This makes for a dramatic conclusion, but the results are not robust. If GDP or FREE is stipulated to be the sole independent variable in a two-stage least-squares regression, then each is found, separately, to be statistically significant. Moreover, the results shown above could change if better instruments for GDP and FREE were found. Kaufmann et al. (1999) and Hall and Jones (1999) report significant results using the proportion of the population that speaks English or French as the instrument for economic freedom.

V. Conclusion

Economic theory indicates that the amount of corruption in a country will affect its level of output. Empirical evidence shows that a country's level of output is related to the amount of corruption. Two-stages least-squares estimation on a cross-sectional data set of 48 countries suggests that GDP per capita and economic freedom have no impact on the level of corruption. This means that economic theory prevails and corruption affects business activity, not visa-versa.

The two-stage least-squares results, however, are not robust. When GDP per capita is used as the sole independent variable in a two-stage least-squares estimation, it has a significant impact on the level of corruption.

The primary value of this paper is to suggest that more research in this area is warranted. And care should be taken in the conduct of that

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research since the results seem to be sensitive to the specification of the model and the choice of instruments.

Nation	CPI	Pop / sq	%>65	GDP / cap	Aforces / 1000	Indep year	Trade partner	Econ freedom	Ener / cap	Output / ener
Argentina	3.0	34	10.2	10300	1.9	1816	0	2.1	74	139
Australia	8.7	6	12.4	21200	3.2	1901	0	1.9	223	95
Belgium	5.3	872	16.8	23400	4.6	1830	0	2.1	247	95
Brazil	4.1	52	5.1	6100	1.8	1822	0	3.5	46	133
Bulgaria	3.3	193	16.0	4100	10.0	1908	0	3.4	115	36
Canada	9.2	9	12.5	22400	2.5	1867	0	2.0	407	55
Chile	6.9	51	7.0	12500	7.2	1810	0	2.0	55	227
China	3.4	343	6.6	3600	2.4	1912	0	3.4	30	120
Colombia	2.9	96	4.5	6600	4.0	1810	0	2.9	36	183
Egypt	3.3	172	3.7	2850	6.9	1922	0	3.5	27	106
France	6.6	279	15.8	22600	8.7	486	1	2.5	169	134
Germany	8.0	607	15.9	22100	4.2	1871	1	2.2	176	126
Greece	4.9	211	16.5	13400	20.3	1829	1	2.75	112	120
Hungary	5.2	286	14.4	7400	7.0	1001	0	2.55	112	66
India	2.9	857	4.6	1720	1.4	1947	0	3.8	12	143
Indonesia	1.7	302	4.0	2830	1.4	1945	0	3.5	18	157
Israel	6.8	719	10.0	18100	34.9	1948	0	2.75	112	162
Italy	4.7	500	17.6	20800	7.6	1861	1	2.3	131	159
Japan	6.0	826	16.0	23100	1.9	-660	0	2.15	170	136
Jordan	4.4	125	3.0	3500	27.3	1946	0	2.9	NA	NA
Kazakhstan	2.3	16	7.0	3100	1.7	1991	0	3.7	NA	NA
Kenya	2.0	129	2.7	1550	0.8	1963	0	3.05	NA	NA
Korean, S	3.8	1224	6.4	12600	14.5	1945	0	2.4	157	80
Malaysia	5.1	165	3.9	10300	6.2	1957	0	2.7	81	127
Mexico	3.4	133	4.1	8300	1.9	1810	0	3.0	58	143
Netherlands	9.0	1200	13.5	22200	4.3	1579	1	2.05	242	92
N Zealand	9.4	35	12.0	17000	2.9	1907	0	1.7	247	69
Nigeria	1.6	314	2.9	960	0.9	1960	1	3.3	7	137
Pakistan	2.2	449	4.0	2000	4.6	1947	0	3.4	13	154
Peru	4.5	53	4.5	4300	4.8	1821	0	2.45	21	205
Philippines	3.6	675	3.6	3500	1.5	1946	0	2.85	14	250
Poland	4.2	328	11.8	6800	7.2	1918	1	2.8	98	69
Romania	3.3	252	13.0	4050	9.5	1881	1	3.3	93	44
Russia	2.4	22	12.5	4000	9.4	1991	0	3.7	176	23
Singapore	9.1	14487	7.0	26300	18.0	1965	0	1.45	NA	NA
Slovakia	3.7	111	11.0	8300	9.7	1993	0	3.0	NA	NA
Slovenia	6.0	252	14.0	10300	5.1	1991	1	3.0	NA	NA
S Africa	5.0	91	4.5	6800	2.4	1910	0	2.9	100	68

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Spain	6.6	203	16.3	16500	5.4	1492	1	2.4	115	143
Sweden	9.4	56	17.0	19700	5.8	1523	0	2.35	255	77
Taiwan	5.6	1759	8.2	16500	20.0	1947	0	2.0	145	114
Tanzania	1.9	89	2.9	730	1.2	1964	0	3.4	NA	NA
Thailand	3.2	304	6.0	6100	4.9	1238	0	2.7	39	156
Turkey	3.6	217	5.7	6600	13.1	1923	0	2.75	43	153
Ukraine	2.6	215	14.0	2200	9.3	1991	0	3.6	122	18
UK	8.6	632	15.7	21200	4.0	900	1	1.9	171	124
USA	7.5	76	12.7	31500	6.2	1776	0	1.8	352	89
Vietnam	2.6	607	5.3	1770	7.6	1945	0	4.3	6	295

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JOYRIDE TO INFINITY

ROBERT A. MCCONNELL PH.D.

Joyride to Infinity is an alarm-sounding book that manages to be at the same time both conservative and radical in its encyclopedic exploration of our future.

The theme is over-population and the resultant evils of mass immigration and environmental pollution. If mankind cannot control its actions, Nature, in her cruelty, will do it for us. The author is a reluctant radical who was forced to acknowledge the extreme findings that he uncovered in his exhaustive pursuit of reality.

Professor McConnell argues that the globalization of our economy is leading to the end of nationhood, mass migration and the uncontrolled growth of population. The causal links are now clear. He sees no hope for sub-Saharan Africa and little hope for China, which faced its population problem too late. The rest of the world is having to cope with the overflow from the regions that are over-reproducing.

Planning for the future requires caring about the future. Those cultures which have no past to preserve will have no future to live in. Cultural Diversity, which begins by denying the past, will never summon the will to sacrifice for the preservation of the Earth as a worthy habitat.

The author is both an engineer and a scientist. As an engineer, his competence was proved as a radar development group leader in World War II. As a scientist with a Ph.D. in physics he is a Research Professor Emeritus of Biological Science, a Life Senior Member of the Institute of Electrical and Electronics Engineers, a Fellow of the American Psychological Society, and a Fellow of the American Association for the Advancement of Science.

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BOOK REVIEW ARTICLE

The Internet Bubble Updated

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The Internet Bubble, published during the information technology bull market, argued that internet stocks were overvalued. The article discusses the role of investors in one of the largest speculative run ups of history, discussing how the bubble occurred and some of the effects of its demise.

Key Words: Risk capital, venture capitalist, internet stocks, market capitalization, speculative

It has now become clear that the great run up in Internet stocks was a bubble. But in the middle of the bubble who had the courage to say so at the time, and to write a book so arguing. The answer is Anthony B. Perkins and Michael C. Perkins, writers for the investment magazine Red Herring. Their book is titled The Internet Bubble (Harper Business, 1999). While most books on new technologies and social trends have a gee whiz characteristic about them, with investment books on technology emphasizing the money to be made, here is a book emphasizing that these stocks had become overvalued, and even attempting to estimate by how much.

Vast fortunes have been made and lost in Internet stocks. It is now becoming clear that this was one of the great speculative run ups of all time, if not the greatest. The Perkins' provide an account of this episode and where much of the money was made. It is clear the fortunes were made by insiders; company founders, venture capitalists, and investment bankers, many institutional investors, as well as by some lucky outside investors. The losers appear to have been small individual investors who bought in at the wrong time.

Besides providing an account of the Internet mania, the book provides descriptions of key players and how they interacted to create and support the bubble. The process starts with an entrepreneur with an idea and the drive to convent this into a company. The examples

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discussed here are the well-known founders of Amazon and Yahoo. Creating a company requires capital. The venture capitalists provide this start up capital. How these venture capital firms emerged and how their financial basis shifted from wealthy individuals to institutional investors is described. The powerhouse firm of Kleiner Perkins Caulfield & Byers occupies a central place in the narrative.

The venture capitalist's goal is typically to develop a firm to the point where its stock can be sold to the public. The first time sale of stock to the public is referred to as an initial public offering (IPO). The growth of this business on the West Coast is described. Particularly fascinating is how Smith Barney sent Robertson there to prospect for business but then failed to accept the deals he located. This led him to set up his own firm, Robertson Stephens, specializing in underwriting IPO's for technology firms. Of course, eventually the big New York based firms did get interested in technology and now compete very vigorously for the business.

Unfortunately, one of the ways they compete for business is by promising analyst coverage of companies. Traditionally, the analysts job had been to provide investment advice for investors, both individual and institutional. Naturally such advisor is most useful if it is impartial. However, most of the brokerage firms are also investment banking firms which derive substantial revenue from selling stock to the public (their fee is typically 7% of the sales proceeds). Thus the analysts are under considerable pressure to say nice things about clients and potential clients. Not surprisingly, at a time when there were vast number of internet firms going public, and when many had business plans which would require additional sales of stock even after the initial public offering, analysts were generally unrealistically optimistic about the Internet. A 1998 Zacks Investment Research survey of analysts reports on 6,000 firms showed that only 1.4% got sell recommendations, while 67.5% were buys, and 31.1% holds. One of the major lessons for investors in this book is to be very suspicious brokerage firm analysts, and especially of those whose firms participated in the underwriting of a firm's stock.

The investors who were able to purchase stock at the opening made much of the money that was made in Internet stocks. During the boom the Internet stocks typically rose well above the offering price on the first day of trading. Since this was general knowledge, there was much competition to get an allotment of stocks at the opening. The investment banks get to chose who gets to purchase at the offering price (virtually guaranteeing the lucky purchasers a profit). The investment bankers, having something of value to allocate, have traditionally (and

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rationally) allocated the new issues to their best customers, which were predominantly institutions, along with a few individual investors. To avoid having the price collapse too soon right after the offering, investment banks have normally tried to avoid selling an issue to those who planned to "flip" it, or sell it immediately after the issue. This is traditionally enforced against individuals by refusing to sell future IPO's to investors who sell them immediately after the offering. However, according to this book the institutions are too important customers to take action against for flipping. As a result, many institutions made very good profits during the boom by being allocated a share of new issues and then immediately selling them.

However, there is another possible explanation for the more generous treatment of the institutions. Individuals hold their securities in an account with their broker. If shortly after purchase the individual sells the securities, the broker knows that and can easily put him on a blacklist for future initial IPO's. Institutions traditionally have their securities held by a custodian, typically a bank. After purchase they are delivered to the bank. Institutions normally deal with multiple brokers. By the simple expedient of asking another broker who did not participate in the IPO selling syndicate to handle the sale of the shares, an institution can sell immediately after the offering without it being known to the broker that originally sold him the shares. Admittedly, the holdings of many institutions are made public periodically (for mutual funds twice a year) and investment bankers could look at these to determine if the stocks they had purchased were still being sold.

Because of the preferential ability of institutions to sell soon after a public offering, it is likely that much of the Internet Bubble profits were made by institutions rather than individual investors. Of course, individuals as holders of mutual funds or pension funds were the ultimate beneficiaries of many of these profitable institutional trades.

What is less defensible is the way some of the stock in hot public issues was allocated to the personal accounts of executives in firms that might some day be able to direct profitable business to the underwriters, typically when their own firms went public.

One reading this account of how firms are taken public is likely to conclude there is a better way. There is no obvious rationale for underpricing an issue and then allowing only a minority of those willing to buy at that price to actually purchase shares. It would seem much better to have a system that determined the market-clearing price and then sold the stock at this price.

Of course, the Internet bubble was not the first bubble and will probably not be the last. Other recent bubbles are discussed. The

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introduction of the personal computer was viewed as revolutionary and it was accompanied by much speculative interest. Venture capitalists funded all sorts of computer related ventures. In fact, there were 43 different firms funded to produce disk drives between 1977 and 1983. Venture capitalists invested $400 million in these companies. A bright future was forecast for each if only it could achieve 10% of the market. Of course, that goal sounded very modest for each firm taken individually, but it was unachievable for the new disk drive makers taken as a group and most were doomed to fail.

Another boom (the subject of a chapter) was in biotechnology stocks following the development of genetic engineering. In the end most of the companies in this field failed to realize their potential. By 1998 there were 350 public biotechnology companies and investors had put 90 billion dollars into these companies. Biotechnology companies had risen in only 7 of the last sixteen years (because such companies seldom pay dividends this indicates more losing than winning years). An investor who participated in every biotechnology initial public offering would have earned a return of only 1% per year.

While much money was lost in biotechnology stocks (as usual, venture capitalists and investment bankers made money), it could at least be argued that much useful research was done. New drugs were developed that will be benefiting people long after the patents have expired (see Robbins-Roth, 2000). Unfortunately, it is hard to make a similar argument for the numerous Internet companies that merely provided a better version of catalogue shopping or that provided consulting services in support of the industry.

Two journalists wrote this book. Thus, the reference list covers mainly the business press and popular books. Yet on some of the topics discussed there is a large academic literature. The reader of this book would get the correct impression that IPO's have been bad investments. However, the large academic literature that could document this impression is not mentioned.

Ritter (1991) examined the returns from 1,526 initial public offerings made between 1975 and 1984. The three-year return was 34.47%. A control sample of 1,526 firms matched for industry and size returned 61.86% over the same three years. Loughran (1993) examined the returns from 3,556 IPO's during 1967-1987 and found an average six year total return of 17.29% compared with 76.23% for the NASDAQ index during an identical period, showing results appreciably worse than Ritter had found for his three year tests. Later, Loughran & Ritter (1995) examined initial public offerings from 1970-1990. They found

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that the average rate of return was only 5% per year for the five years after issuance, compared to 12 percent for firms of comparable size.

Building on my earlier work (Miller 1977), I just recently published (Miller 2001) a theory explaining these low returns. Essentially, prices are set by the most optimistic investors. The greater the disagreement about the true value of the stock, the further the opinion of the most optimistic investor is from the average opinion. Of course, since the future of new technology companies is very hard to forecast, there will normally be a great deal of uncertainty about their true values and much disagreement. This effect is possible even if on average estimates are correct. However, as shown by this book, the estimates for the Internet companies were far from unbiased, with the most extravagant claims being made. As Shiller (2000) points out this was a period of great optimism in the stock markets.

An appendix provides detailed calculations giving the market values for 133 internet stocks, each with market capitalization of over 100 million dollars, and their revenues along with estimates of how fast the companies would have to grow over the next five years to justify the current (June 11, 1999) prices. At that time, this portfolio had a market value of $410 billion dollars based on combined sales of 15.2 billion (much of the sales came from only two companies, America on Line and Qwest) and with whopping losses of over $3 billion. Only 22 of these companies actually showed profits. The Perkins close their book with an open letter to investors (titled "Sell now") saying Internet stocks are over-valued and urging, "If you hold any of these stocks, it is time to sell". If only investors had read this book and acted on this advice many billions would have been saved.

To see how prescient the Perkins were the portfolio management tool on the Yahoo web site was used to update the tables provided by Perkins. Naturally some companies have disappeared or merged since the Perkins did their calculations. The attached table shows the market capitalization for firms when the Perkins did their book and the market capitalization for the surviving firms as of July 24, 2001. As of July 24, 2001, 80 firms still existed and their market capitalization (i.e. the total value of the firm) had declined for most of the firms (market capitalization declined to less than 100 millions for 45 firms out of this surviving 80 firms). Interestingly, this collapse appears across the board with virtually no firms being worth more now than they worth in mid-1999. For two of these the greater valuation was due to mergers (America On Line and Earthlink). The three firms whose market values were still ahead of their mid-1999 values were Actuate, Verisign, and Vignette, three relatively small firms that are still worth slightly more

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than they were worth in mid-1999. At the peak of the bubble many recognized that most firms would not make it, but argued that the winners would do well enough so that Internet investors could still show a nice profit. It now appears that investing in virtually any Internet stock during the peak of the bubble would have been a disaster.

The updating of the Perkins' analysis was done using the Yahoo portfolio tool. This makes it possible for the reader of this article to see the latest data on the surviving internet stocks. Anyone who wants to see the current capitalization for the surviving internet companies can go to http://finance.yahoo.com and log in with this user name: mithu_uno and this: password: Amarsonamoni. Naturally some companies have disappeared (65 firms) or merged since the Perkins made their evaluations. The Appendix shows the market capitalization for firms when the Perkins did their book and the market capitalization for the surviving firms as of October 12, 2001. However, as of October 12, 2001, 68 firms still existed and their market capitalization (i.e. the total value of the firm) had declined for most of the firms. Interestingly, this collapse appears across the board with virtually no firms being worth more now than they worth in 1999 (except America Online, Actuate Corp., Verisign Inc. and Earthlink Inc.). This is important because at the time many investors recognized that many firms would not make it, but argued that the few winners would succeed well enough so that investors in Internet stocks could still show a nice profit. It now appears investing in virtually any Internet stock during the peak of the bubble would have been a disaster.

The market capitalization for American Online (AOL) and Earthlink Inc. are higher now because they are merged with Time Warner and Mindspring respectively. Excluding AOL the total capitalization of the surviving Internet firms was approximately 54 billion dollars on October 12, 2001. These same firms had a total capitalization of approximately 174 billion dollars on June 11, 1999. AOL (the most valuable internet company by far) is excluded because of its merger with the media giant, Times Warner. This greatly increased the size of the firm and would otherwise make the comparisons invalid. The table below classifies the firms by their function in the Internet economy (classified as Perkins did), showing the magnitude of the declines in each.

Besides the losses to individual investors, it is likely that society suffered from diverting risk capital from other fields. Robbins-Roth (2000) in her book on biotechnology (which has had its own bubbles), describes how venture capital for developing new drugs had virtually dried up because the venture capitalists were chasing the opportunities

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to create new internet firms that could be taken public at a vast profit shortly after creation, while firms to create new drugs (a process that takes about a decade from idea to governmental approval) offered much lower returns. Yet as she points out, there is much more social benefit in life saving drugs than in new methods for selling dog food over the Internet.

Comparison Between the Market Capitalization of the Surviving Companies

Group	*June 11, 1999 Market Cap. In million dollars*	*Oct 12,2001 Market Cap. In million dollars*	*% Lost of Market Cap.*
Commerce	65,087.40	22,536.30	65.38%
Content*	41,486.50	10,306.40	75.16%
Enabling Services	18,629.10	1,888.00	89.87%
Enabling Software	26,639.10	16,081.70	39.63%
Enabling Telecom Service	21,922.70	3,147.00	85.65%
Total	173,764.80	53,959.40	68.95%

* *Excluding AOL*

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Race, Marxism and the "Deconstruction" of the United Kingdom

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Published in October 2000, *The Future of Multi-Ethnic Britain* is the latest, and to date, the most comprehensive, multicultural blueprint for the United Kingdom. Two assumptions are central to the report: first that race is a social and political construct not a biological or genetic reality; and second that the cultural homogeneity of the United Kingdom has been politically and socially constructed and can therefore be deconstructed only to be reconstituted into a multicultural/multiracial 'community of communities'. This article examines the report's position on national identity and history, racism, free speech and hate crime, education, the arts, media and immigration.

Key words: Arts, education, free speech, hate crime, history, immigration, Lenin, Macpherson Report, Magna Carta, Marxism-Leninism, multiculturalism, national identity, neo-Marxism, race-Marxism, Parekh Report, racism, anti-racism, rule of law, social and political construct, sovietization.

Introduction

Cities and towns the length and breadth of Britain – from Bristol, the Medway towns, Slough and London in the south, to Birmingham and Leicester in the Midlands, to Bradford, Burnley, Edinburgh, Glasgow, Leeds, Oldham, Leicester and Manchester in the north – all now harbour large populations of non-white immigrants, a significant proportion of whom, for various reasons, refuse to or are unable to adapt to the host country. Over the last 20 years violent street confrontations between the native indigenous majority population and black and Asian immigrants have become depressingly familiar. In fact, racial strife is now a recognizable feature of the British urban landscape. Meanwhile, the numbers of legal and illegal immigrants entering the United Kingdom continue inexorably to rise. By any standards these are dramatic changes in an already densely populated and traditionally, racially homogenous country such as Britain. Given the failure of the British government to address the scale of the problem, it is reasonable to assume that the worst is still to come. And the problem is by no means confined to the United Kingdom. Similar and equally deleterious effects of legal and illegal immigration can be observed all over the Western world.

The native British population faces two threats from these changes, one immediate and on-going, the other a distinct possibility in the next

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two decades. For the present, there is the covert and overt war being waged against the indigenous majority population, against its history, language, folkways, culture and traditions. This is a war in which multiculturalists exploit existing institutions – the legal system, the education system at all levels (especially the universities), the print and broadcast media, parliamentary democracy and free speech – to achieve their goals (Bork, 1997, Honeyford, 1998, Vazsonyi, 1998). These methods are analogous to those used by Soviet commissars to sovietise Central and Eastern Europe after 1945 (Ellis, 2001). Attacked in this way, institutions retain their outward form but the heart is torn out, the soul extirpated. Incapable of defending themselves, these institutions and the people who work in them can no longer serve the nation state that has created and nurtured them over the centuries. A second, long term threat is terrorism. Street riots, as the experience of Northern Ireland and the Israeli/Palestinian conflict demonstrate, can easily escalate to well organised terrorist campaigns against the security forces. It is difficult to see what would prevent determined militant immigrant groups from using the same means, were they so minded, especially were they wedded to some form of Islamic fundamentalism.[1] In this regard "Islamophobia", fear of Islam, is fully justified.

Two reports published in the UK in the last two years, *The Stephen Lawrence Inquiry: Report of an Inquiry by Sir William Macpherson of Cluny* (1999), sponsored by the British Labour government, and *The Future of Multi-Ethnic Britain: Report of the Commission on the Future of Multi-Ethnic Britain* (2000), sponsored by the Runnymede Trust, and authored by Bhiku Parekh (both reports being more widely known, respectively, as *The Macpherson Report* and *The Parekh Report*) illustrate the scale of the threat to the white indigenous majority population. For, in their respective analyses of British society and the recommendations they propose, both these documents represent a fundamental break with the norms of English common law and culture. In his report of the police investigation into the murder of a black teenager, Sir William Macpherson, a retired British judge, accused the police of "institutional racism". Predictably, the consequences on police morale have been disastrous. On the streets, ever fearful of attracting the catch-all "racist" label, the police have adopted a low-key approach towards non-white suspects. The result has been an increase in the number of violent street crimes as immigrant criminals operate with apparent immunity from prosecution (something which has been observed in Cincinnati and

[1] Written before the atrocities of 11th September 2001, this sentence, with hindsight, borders on understatement.

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Seattle in the aftermath of black rioting). More worrying in the long term has been the readiness of many senior police officers uncritically to accept Macpherson's accusations and, perversely, to revel in public displays of self-flagellation and self-accusations of "racism".

Based on the illiberal neo-Marxism that underpins so much of multiculturalism, *The Parekh Report* is a far more comprehensive and aggressive attack on the United Kingdom than its predecessor. For example, Parekh, believes that we in the UK are suffering from 'multicultural drift' (Parekh, 2000, 11) and that what is required is 'a purposeful process of change' (Parekh, 2000, 11). Later in the report, and with obvious approval, Parekh cites a respondent who argues that: 'People in positions of power *must really believe*, in their hearts and minds, that black and white are equal' (Parekh, 2000, 141, emphasis added). And again in chapter 20 we are given the thoughts of an anonymous race bureaucrat: 'Training is encouraging people, but we have reached the stage where *people must be told to do it or else*' (Parekh, 2000, 284, emphasis added). We have been warned.

National Identity and History

History's would-be nation killers have always understood that to subjugate or to weaken a nation it is necessary to destroy a nation's sense of history, or at the very least dilute it. In the twentieth century the masters of the genre have always been communists or other activists of the left, such as Ceausescu, Lenin, Stalin, Mao, Pol Pot and Kim Il Sung. For the multicultural agenda to succeed in the UK the indigenous majority population must be convinced or intimidated into believing that it is just one of a number of groups, with no special privileges conferred by the past, then opposition to the coercive incorporation of large numbers of non-white aliens will be made all the more easier (or so believe the advocates of multiculturalism). In practice, however, there is widespread resistance, instinctive and rational, and frequently violent, to multiculturalism in the UK. This can be seen not just in the street confrontations between gangs of Asians and indigenous whites but in the periodic outbursts of politicians who, having expressed views contrary to orthodoxy, then recant in spectacular fashion, John Townend, the former Conservative Member of Parliament for East Yorkshire being the latest example.

Any one who reads *The Parekh Report* can have no doubt that the destruction, or in postmodernese the "deconstruction" of any strong white identity, is one of Parekh's main aims. Thus, in the preface Parekh talks of 'the non-existent homogeneous cultural structure of the 'majority' (Parekh, 2000, x), only, subsequently, to expend vast amounts

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of ideological energy attempting to destroy something, which, apparently, does not exist. When whites are no longer able to say "we", they are vulnerable to groups of non-white immigrants who most assuredly are encouraged to promote the use of "we" at the expense of the host society. To this end, divide, weaken and rule are the essential policies deployed by Parekh against the white, indigenous majority population. Cast as victims, the Irish are singled out for sympathetic treatment, as are the Scots and Welsh.

Symptomatic of Parekh's confusion and muddle on the question of race is the astonishing disclaimer in chapter 10 that: 'Irish people are classified as white for statistical purposes' (Parekh, 2000, 130). Curiously, while highlighting Scotland as a special deserving case, a victim of the English rather than a beneficiary of the 1707 Act of Union, Parekh pointedly refrains from criticising the nationalist movements in both Wales and Scotland. In fact, he justifies them in a way which would not be the case were there a strong English Nationalist movement: 'The rising tides of nationalist sentiment in Scotland and Wales, however, have clearly been driven by historical resentments of long-standing relations of privilege and dependency' (Parekh, 2000, 21).

Among the Scottish politicians, I suggest, any drive for nationalism is inspired not by images of *Braveheart* but by the tantalising possibility of bypassing Westminster and acquiring ever more generous subsidies from the European Union (EU). Any English National Party would be singled out by Parekh for putting the interests of the indigenous British population before aliens and foreigners, whereas the perfectly legitimate aspirations of the Scottish National Party towards independence are ignored. There exists an unbridgeable contradiction between Scottish nationalism and the multicultural agenda which Parekh wishes to impose on the English (Linsell, 2001). And violent conflict between native Glaswegians and large numbers of immigrants in the summer of 2001 over the allocation of resources - the wave of the future - supports this view. Parekh applauds the rise of Scottish and Welsh nationalism not out of any regard for these legitimate aspirations towards Welsh and Scottish independence, which his multiculturalism obliges him to reject, but for the weakening effects it has on the British identity as a whole. On the other hand, any similar sense of identity or national revival among the English is to be deplored as 'a new kind of little Englandism' (Parekh, 2000, 24).

Especially resented is Bill Bryson's, best-seller, *Notes from a Small Island*, first published in 1995. Bryson's crime in Parekh's eyes is that he omits blacks, Asians and others from his story of a small island. Such omissions are perfectly rational. For these minorities have arrived very

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late in the day and the national story can only 'exclude them'. Here we have another reason why English history and the history of the United Kingdom have to be written off and where that is not possible, rewritten Orwellian-style to suit the purposes of multiculturalism. Trafalgar, Oliver Cromwell, the English Civil War, the Battle of Britain, the Somme, the Falklands, Sir Isaac Newton, Shakespeare, Elizabeth I are hardly likely to inspire the same love, admiration or other emotions in immigrants as they do in the white indigenous majority population. And why should they? Quite reasonably, Asians and blacks look to their own. With regard to Bryson, Parekh is also guilty of an omission of his own, failing to point out to the reader that Bryson is a white American, who clearly loves Britain, warts and all.

Identity is inextricably linked with history and so it is to be expected that Parekh and his social engineers wish to "deconstruct" British history to serve their purposes. Having noted that the Act of Union in 1707 created Great Britain, Parekh then argues that: 'The dominant national story of England includes Agincourt, Trafalgar, Mafeking, the Somme and Dunkirk' (Parekh, 2000, 16). To be sure, the Royal Navy was founded by an English King and Nelson's historic address was to Englishmen to do their duty, but Trafalgar was fought and won in 1805 nearly a century after the Act of Union. Though the vast majority of Nelson's sailors were Englishmen, the consequences of defeat would have affected all of Britain, not just England. Likewise, it was not just English soldiers who fought and died at the Somme. Nor can the English, as Parekh implies, lay sole claim to the miracle and the pain of Dunkirk. For the memory of Dunkirk is also the memory of the surrender of the *British* 51st Highland Division at Saint-Valéry. Dunkirk, as the Somme, belongs to a number of great and sometimes painful moments in the life of Britain. This can be appreciated in a memorable passage taken from Alistair Maclean's *HMS Ulysses*, possibly that Scottish writer's finest novel, and certainly one of the best we have of the Battle of the Atlantic in World War Two. A senior naval commander feels the crushing weight of command and reflects upon the *British* lives lost in the Atlantic as the convoy battles its way through repeated German air and U-boat attacks:

> And the broken sorrowing families, he thought incoherently, families throughout the breadth of Britain: the telegram boys cycling to the little houses in the Welsh valleys, along the wooded lanes of Surrey, to the lonely reek of the peat-fire, remote in the Western Isles, to the lime-washed cottages of Donegal and Antrim... (Maclean, 1955, 170)

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These are crucial defining moments in British history which bring English, Scots, Welsh and Irish together. History can bind as well as divide.

Especially dubious in the Parekh deconstruction of English and British history is the emphasis placed on imagining history, part of a much wider attack on traditional method inspired by French radical theories, so popular in the academy (Windschuttle, 1997). If history is just imagination, then anything goes and anything can be claimed and the way is open for all kinds of charlatans to take centre stage. Imagination is hardly a reliable historical source. Imaginative use of historical data and documents is another matter entirely. There is, Parekh points out, more to Britain than just England, which is true enough. But England was and remains the economic powerhouse of Britain. This has long been obvious to foreign observers. Russians, for example, routinely refer to Britain and the UK as *Angliya* the Russian word for England. And the Irishman, Edmund Burke, pointedly writes of "we English" in his *Reflections on the Revolution in France*. English Common Law, the break with Rome, The Book of Common Prayer, the model of parliamentary democracy and free speech, the special role of maritime matters in shaping the life of the country (this after all was why Trafalgar was so decisive since it guaranteed British naval supremacy for nearly 150 years) have all contributed to England's special nature. Foreign observers have well understood the monumental significance of the evolution of private property, free speech and parliamentary democracy in England and the benefits for the rest of the world unlike Parekh who seems to be trapped by his parochial multiculturalism. A mere 20 miles of water separates Britain from continental Europe, yet the effects of this separation have been profound for the political, cultural, intellectual and religious development of Britain. What we have here in the separate and highly distinctive political and cultural evolution of Britain is perhaps analogous to what happens in genetics, namely that very small differences in the genes can have large phenotypic consequences. As with race, it is not the size of the genetic difference but rather the impact that change has on the phenotype.

None of these differences, however, has deterred Parekh from asserting that the uniqueness of the British system of parliamentary democracy 'is not supported by the known historical facts' (Parekh, 2000, 19). In part this is correct. For the system is a uniquely English contribution to world civilization, certainly not Welsh, Scottish or Irish, though Irish and Scottish thinkers, most notably, Edmund Burke, David Hume and Adam Smith, have shaped this process. In reviewing the role of representative institutions in continental Europe, Richard Pipes notes

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that there were various assemblies in Spain, Scotland, the Netherlands, Poland, Sweden and Denmark. None, however, was as successful as the English. Pipes argues, convincingly, that: 'one factor that bolsters parliamentarism is territorial smallness. As a rule, the smaller the country and its population the easier it is to forge effective democratic institutions, because they represent manageable communities with shared interests and are capable of concerted action: conversely, the larger a country the greater is the diversity of social and regional interests, which impedes unity.' (Pipes, 1999, 153). Pipes, in other words, recognises the importance of homogeneity, cultural and racial. Again, Pipes notes, it was to England's advantage that she 'never developed provincial parliaments' (Pipes, 1999, 153). This, of course, is something that the EU is desperately trying to foist on England so as further to weaken any strong sense of English national identity, and yet another reason why Parekh wants the British to cast away their independence and become totally absorbed into the EU.

Discussion of religious conflict in Britain is intended to show that there has always been strife in Britain and division over religious matters between the people of England, Scotland and Ireland. Thus, runs the argument, the conflicts arising over multiculturalism in the UK are part of this on-going historical conflict and adaptation to change. Three points can be made here. First, there is the question of race. The idea that since large numbers of Normans, Saxons, Jutes and Danes have come here and settled is not in itself an argument in support of large scale non-white immigration to the UK. None of these were genetically very distinct from the earlier population of the islands. The Norman Conquest imposed a very thin layer on the Anglo-Saxons and by the 14th and certainly no later than the 15th century, the Normans had been totally absorbed into Anglo-Saxon England (Johnson, 1995). Second, if, as Parekh believes, race is a social and political construct, not something that has evolved in different parts of the globe in response to differing survival challenges, then the large scale legal/illegal immigration is simply a matter of "deconstructing" the dominant white indigenous identity and reconstructing it along multicultural lines. (Note for example the title of chapter 3 "Identities in Transition"). As we know from countless historical examples, people and nations emphatically do not lend themselves to this kind of neo-Marxist moulding and remoulding. For better or for worse, race matters, and will continue to matter, however much people such as Parekh and others deny it.

Third, desperate to convince us of the benefits of multiculturalism, Parekh fails to provide any convincing evidence from anywhere in the world, past or present, of a successful and enduring multicultural

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(multiracial) society. Catastrophes and bloody failures on the other hand are easy to find: Rwanda, Zimbabwe, South Africa, Yugoslavia and the Soviet Empire. For all the differences and disagreements that exist among the white indigenous majority population, when Britain has been in peril the nation has pulled together. Similarly, Russians rallied to fight the Germans in the darkest days of the German invasion not out of loyalty to the Comintern (the Soviet version of multiculturalism) but out of deep love of Mother Russia. In the words of Viktor Kravchenko: 'At the core of a nation there is a hard, eternal and unconquerable element - it was this that was bared in Stalingrad, that survived blood-letting and disaster on a horrifying scale. It had nothing to do with Karl Marx and Stalin' (Kravchenko, 1946, 402). And whether it was Henry V's band of brothers on the eve of Agincourt, Nelson's Jack Tars at Trafalgar, or the Few in the summer of 1940, it was love of hearth and country and a sense of duty, tempered by military discipline, that prompted soldiers, sailors and airmen to risk their lives in battle, not the perverse, unnatural abstractions of multiculturalism. Parekh is oblivious to the very history and its significance that he wishes to erase.

In citing a great many things that bind people into something called a community - many of which are sensible - Parekh unwittingly cites reasons why multicultural societies cannot remain stable and why there is so much friction. He argues that a sense of belonging is needed, failing to see that multiculturalism destroys that very sense of belonging. The cult of multiculturalism demands that white Englishmen value the achievements (or in many cases the non-achievements) of foreigners above those of native Englishmen. Now, granted many of what one might regard as better and, in some cases, superior achievements include a degree of subjectivity. But not all. For example, the scientific achievements of Europeans completely overshadow those of Sub-Saharan Africans. We can argue about why this is so, but the enormous disparity in achievement remains (for an analysis of the relationship between national IQ and economic performance see Lynn & Vanhanen, 2001).

Having ridiculed the idea of the nationalist state, Parekh then argues for something called 'One Nation'. In passing one can note that Parekh's use of 'One Nation' bears a close resemblance to Evgeniy Zamyatin's use of 'One State' in his powerful satire of Soviet totalitarianism, *We*. In Zamyatin's 'One State', the inhabitants, or numbers, as they are called, live out a wretched existence in which every possible aspect is governed by a brutal bureaucracy. Orthodoxy (multiculturalism?) is associated with mental health, dissent (belief in the nation state?) with madness. Written in the early 1920s and then

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banned by the communist party for over 60 years before being finally published in the Soviet Union in 1988, *We* turned out to be a dire prediction of totalitarianism. And twenty five years after *The Camp of the Saints* was first published, Jean Raspail's deeply disturbing analysis of cowardly politicians and intellectuals and enervating compassion is proving to be a similarly dire prediction of multicultural distemper.

Parekh's idealised 'One Nation' will not be based on a unifying and enduring national identity. Only bureaucratic coercion and something akin to Soviet-style totalitarianism can hold things together. This is conceded by Parekh when he talks of 'substantive values' or 'common values':

> Substantive values are those that underpin any defensible conception of the good life. They include people's freedom to plan their own lives, the equal moral worth of all human beings, and equal opportunities [...] On the basis of such values it is legitimate to ban female circumcision, forced marriages, cruel punishment of children and repressive and unequal treatment of women, even though these practices may enjoy cultural authority in certain communities (Parekh, 2000, 53-54).

Once again we are confronted with the barrenness of postmodernism; the view that identities can be remade and reinvented; that they are endlessly malleable. Ultimately, there are no privileged perspectives and one idea of the good life is no better than anyone else's conception of the good life and emphatically not superior to it. Given that multiculturalism recognises no one culture as superior to another, the support for banning female circumcision, for example, is rather odd. If female circumcision enjoys 'cultural authority', then the very essence of multiculturalism with its endless calls to respect something called "diversity" demands that this authority be respected.

There is of course a profound irony here of which Parekh is painfully unaware. For it is preeminently Western societies, and within that framework, English traditions of equality before the law and the assertion of individual rights, (the Taliban, as far as one can tell, did not have *habeas corpus* or free speech) that provides the moral, legal and intellectual basis for banning the non-white practices of female circumcision, arranged marriages and unequal treatment of women. Parekh needs to be reminded that it was in the sceptred isle that the ideas of individual freedom, the rule of law and parliamentary democracy were born and bred, certainly not in India, Pakistan, Japan or China, let alone Africa.

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Racism

Parekh has much to say on the subject of racism and the definition offered differs substantially from that given in *The Macpherson Report*. According to Parekh:

> [...] racism, understood either as a division of humankind into fixed, closed and unalterable groups or as systematic domination of some groups by others, is an empirically false, logically incoherent and morally unacceptable doctrine (Parekh, 2000, ix).

No doubt Parekh believes that 'empirically false', 'logically incoherent' and 'morally unacceptable' is the trident that slays the dragon of racism. The Parekh definition of racism is a fallacious diversion, since it attacks a straw man. It is not at all obvious that scientists accept the division of mankind into 'fixed, closed and unalterable groups' which, as has been pointed out by Arthur Jensen was an idea advanced by Plato's politics in c.370 BC not one found in modern genetics (Jensen, 1998, 420). What can be demonstrated empirically - whether many will accept the findings publicly is another matter - is that race is something much more than an exogenous factor.[2] In the light of the vast amount of data now available, Arthur Jensen's definition of races is far more convincing, and more importantly, independently verifiable, than the unreconstructed Marxism of Parekh. According to Jensen: 'Races are defined in this context as breeding populations that differ from one another in gene frequencies and that vary in a number of intercorrelated visible features that are highly heritable (Jensen, 1998, 421). And both Vincent Sarich (1995, 85) and Jensen (1998, 423) have applied the notion of fuzzy sets to race, neatly turning one of multiculturalism's most hallowed metaphors - the rainbow - against it in the process: To quote Jensen:

> The fact there are intermediate gradations or blends between racial groups, however, does not contradict the genetic and statistical concept of race. The different colours of the rainbow do not consist of discrete bands but are a perfect continuum, yet we readily distinguish different regions of this continuum as blue, green, yellow and red, and we effectively classify many things according to these colors. The validity of such distinctions need not require that they form perfectly discrete Platonic categories (Jensen, 1998, 425).

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[2] Later in the report Parekh cites a correspondent who bemoans the fact that: `Young children are not colour blind. As young as two or three years old they are aware of differences between the people around them...' (Parekh, 2000, 149). Is this evidence for a genetic preference for one's own race or evidence that race is something inculcated into children.

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Yet this has not deterred Parekh from asserting that: 'Race, as is now widely acknowledged, is a social and political construct, not a biological or genetic fact. It cannot be used scientifically to account for the wide range of differences among peoples' (Parekh, 2000, 63).[3] At no stage in this report does Parekh attempt to justify the basis on which he makes this astonishing assertion. We are expected to take it on trust. While one would not expect to see the names of John Baker, Thomas Bouchard, Chris Brand, Carleton Coon, Jon Entine, Hans Eysenck, Linda Gottfredson, Arthur Jensen, Michael Levin, Richard Lynn, J. Philippe Rushton, Vincent Sarich and Glayde Whitney in the bibliography, one would most certainly expect to find the names and works of Stephen Jay Gould, Leon Kamin, Richard Lewontin and others who deny the biological and genetic basis of race and who, when they attack the hereditarians, as they are called, are given pride of place in the print and broadcast media as being the legitimate voice of science, whereas Baker *et al* are to be dismissed as cranks or worse. One anomaly is the inclusion of Charles Murray's & Richard Herrnstein's *The Bell Curve: Intelligence and Class Structure in American Life* in the bibliography, though, curiously, the sub-title is omitted. Equally curious is the absence of any attempt to challenge the Murray & Herrnstein thesis that: (i) race has a biological basis and; (ii), to challenge the well established empirical finding of a 1 standard deviation between average black and white IQ. Parekh passes up an opportunity at the very least to criticise Murray & Herrnstein.

Since the whole basis of multicultural social engineering rests on the assertion that race is a social and political construct and not a biological or genetic reality, Parekh's assertion is of the greatest importance. That this assertion - no more - is repeatedly cited as evidence that those who oppose multiculturalism are racists, the omission of any source material in *The Parekh Report*'s lengthy bibliography or endnotes, which would serve to provide some independently verifiable corroboration of this all important assertion is quite striking. Why this obvious omission? I speculate that the reason the latter set of names is absent is because Parekh is deeply worried that by citing *any* authors who have written about race, pro or contra, he is merely drawing attention to the huge amount of evidence in the professional and specialist journals, as well as the many monographs, all in the public domain, and, as a result, the

[3] Parekh's approach to race can also be seen in his egregiously political/ideological definition of what he calls sexism: 'Similarly, sexism involves seeing all differences between women and men as fixed in nature rather than primarily constructed by culture' (Parekh, 2000, 67, emphasis added).

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huge discrepancy between what many scholars say publicly on the subject of race and what they accept professionally. Studying this huge reservoir of empirical data, independently minded individuals might just be dissuaded from the notion that race is a social and political construct. To this end *The Bell Curve*'s sub-title might well stimulate interest in forbidden territory, indicating, as it does, that there is link between intelligence and socio-economic status. Unable to bypass the question completely, Parekh nevertheless wants to shut the discussion down as soon as is possible. This implies that he is possibly aware that race is *not* a social and political construct or that he is ignorant of the developments made, and which continue to be made, in genetics and evolutionary biology.

Some of the objections to race as a genetic reality cited by Parekh are the usual collection of fallacies. We are told that there is more genetic variation within one group, or as Parekh writes, 'any one so-called race than there is between 'races'' (Parekh, 2000, 63). Again, Jensen's comment is far more convincing, since it has withstood independent scrutiny:

> [...] individuals in a given group differ only statistically from one another and from the group's central tendency on each of the many imperfectly correlated genetic characteristics that distinguish between groups as such. The important point is that the *average* difference on all of these characteristics that differ among individuals *within* the group is less than the *average* difference *between* the groups on these genetic characteristics (Jensen, 1998, 425 [emphasis in the original]).

In view of the data – psychometric, genetic and statistical – that have been accumulated over the last 150 years, Parekh's assertions are an example of the perverse refusal to recognise let alone to evaluate, some of the enormous strides made in evolutionary biology, genetics (the Human Genome) and physical anthropology, since the time of Darwin. The view that race is a social and political construct is race Marxism and, in Parekh's own words, 'empirically false'. Far from rejecting the idea of race being a social and political construct, the state of scientific knowledge as of 2001 provides powerful empirical evidence for the view that race is a biological and genetic reality which can be readily subjected to objective mathematical and statistical analysis. Race is not something that has been invented by "Neo-Nazi racists".

Interestingly, but perhaps not surprisingly, for all his assertions that race is a social and political construct, Parekh evasively notes that: 'Some diseases disproportionately affect certain communities' (Parekh, 2000, 178), implying that this is due to cultural conditions alone. Again,

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despite his insistence that race is a social and political construct, Parekh bemoans the fact that: 'people from South Asia are at risk of thalassaemia' and are not offered '*genetic* counselling' (Parekh, 2000, 179, emphasis added). Even advice from the British Prime Minister's Cabinet Office, cited with approval by Parekh, insists that statistics regarding illness and diseases be 'separated by race' (Parekh, 2000, 181). As Parekh acknowledges, almost all the sufferers of sickle cell disease are of African descent, and the disease is found in black populations throughout the world. Race as a social and political construct cannot account for this distribution pattern, whereas the genetic explanation is simple: the link between race and disease is medically established (Rushton, 1999). Parekh's position on race is, in his own words, 'logically incoherent'.

Parekh's main contribution to the genre of racism is the invention of 'cultural racism' (Parekh, 2000, 148). Now, if according to Parekh race is a social and political construct, that is, above all cultural in the sense that things social and political make up culture, 'cultural racism' is pure tautology and meaningless. That in itself does not make it useless, given that so much that has anything to do with anti-racism is incoherent. Placing any suitable adjective before racism frequently leads to contradiction and incoherence, but it has a wonderfully intimidating effect which weakens the will to resist in a logical manner. Therein lies the purpose of creating 'cultural racism'. The danger of arguing that race is a social and political construct is that if you attack some aspect of culture you are racist. So if you attack the practice of female circumcision you are racist or, as Parekh says later in the report, guilty of 'cultural racism'. And it should be understood that any sense of disgust, articulated or otherwise, towards such practices is itself a manifestation of cultural racism.

Free Speech and "Hate" Crime

Barely hidden and frequent attacks on free speech by trying to argue that incitement to racial hatred must be avoided are some of the more sinister aspects of *The Parekh Report*. This leaves plenty of room for those promoting multicultural/multiracial societies to assert that anything they do not like is somehow guilty of inciting racial hatred and thus that certain areas be barred from discussion (race as a biological and genetic reality, racial differences and IQ, immigration, for example). This attempt to censor critics becomes more important in the light of recommendation 12 of *The Macpherson Report* which provides a definition of a racist incident ('A racist incident is any incident which is perceived to be racist by the victim or any other person').

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An insidious attempt to set limits to certain Anglo-Saxon rights is implicit in the assertion that: 'Human rights are thus rarely absolute but can be limited in order to protect the rights of others' (Parekh, 2000, 91). Decoded, and with reference to free speech, this means, I suggest, that rights of free speech, rightly regarded as the basis of all open and free societies, should not apply to those who criticise the multicultural/multiracial experiment. Since Asian and black societies have never independently recognised the value of free speech as the basis of a free and open society or shown much respect for it in the aftermath of European colonial withdrawal, immigrants to the UK from sub-Saharan Africa and the Indian subcontinent cannot reasonably be expected to grasp the importance of free speech or to defend it with the same tenacity as white Anglo-Saxons. For the indigenous whites of England and European civilization as a whole, however, a great deal is at stake. Western civilization is inconceivable *and unsustainable* without free speech.

'Crucially', pleads Parekh, 'restrictions on rights are legitimate only if such restrictions are proportionate to the harm they are trying to prevent' (Parekh, 2000, 91). Bearing in mind that, as far as the multicultural ideologues are concerned, racism is the great evil, then this paragraph provides a convenient basis for restricting free speech. What we have here is the typically postmodernist agenda - cloaked in the language of human rights - which asserts that any standard it wishes to destroy or subvert (in this case free speech) is relative and can claim no privileged perspective, but that any standard it wishes to enhance or to promote (multiculturalism, race is a social and political construct for example) most certainly is deemed to be a privileged perspective and thus worthy of special moral and legal status (its critics are to be silenced and vilified as racists). And if this is insufficient warning of what Western societies can increasingly expect, we should note the report's demand that human rights 'be interpreted and applied in a culturally sensitive manner' (Parekh, 2000, 91). People who attack multiculturalism, in other words, are behaving in a culturally insensitive manner and must be silenced. True enough, 'the logic of multiculturalism qualifies and informs the logic of human rights' (Parekh, 2000, 91), but it does so in a way which is inimical to logic and human rights and exposes the multicultural agenda as both illogical, deeply illiberal and, despite its assertions of inclusiveness, as monochromatic: white is second best.

Note, for example, Parekh's illogical and illiberal approach to the Human Rights Act 1998: 'Freedom of expression may assist individuals who are not allowed to wear clothing at work or school which is

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important to them for religious or cultural reasons' (Parekh, 2000, 97). This is, I assert, a perverse interpretation of the Act. 'Freedom of expression', as stated in the Act, has no relevance for wearing or not wearing certain items of clothing. As always, the special pleading on behalf of blacks and Asians - and in the example just noted, a perverse and illogical interpretation of the Act - is accompanied by the assertion that the rights and freedoms are not absolute and can be restricted in certain circumstances: 'Crucially, the infringement will have to be proportionate to the harm that the authority is trying to prevent' (Parekh, 2000, 97). Not specifically mentioned, I again suggest that the rights to free speech, as opposed to the right to wear unsuitable clothing at school or at work, are the rights that Parekh really wishes to violate.

Hate crime, with its appropriately Orwellian ring, is another invention of multicultural ideologues who are trying to silence opposition and criminalise the thoughts and utterances of those who disagree with them. Special pleading is again evident in the way in which Parekh characterises hate crime:

> Hate crime in general, and racist crime in particular, has a character that distinguishes it from other kinds of crime. The difference lies not only , and not primarily, in the offender's motivation, but in the greater harm done (Parekh, 2000, 127).

It is not at all clear why hating or disliking someone, so long as the hate does not lead to physical violence or other forms of law breaking, should automatically be seen as something criminal. Any expression of dislike, indifference, mild disapproval or resentment directed at multiculturalism or blacks will, naturally, always be regarded as an expression of hate, rather than one of the milder forms of rejection. Nor is it immediately apparent why racially offensive language - a hate crime - must be considered more harmful than muggings, rape and murder. Murder is serious because it is murder. The power of hate crime to silence and to intimidate opponents of multiculturalism is a direct consequence of recommendation 12 of *The Macpherson Report* (see above). Hate crime is based on the notion that hating people is a crime, which in certain contexts and situations might well be suspect, or even morally reprehensible, but in other cases might well be a wholesome and logical response to clear and present danger, such as, for example, the discovery that some 7,000 of your fellow citizens have been murdered by Islamic terrorists.

Worse still, what Parekh calls racist crime is not just an attack on an individual but on the community because that individual is a member of a community. This conclusion does not follow at all but it is

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nevertheless revealing of the mindset of multiculturalism which sees individuals primarily not as individuals but as cogs in a machine, or in the language of race Marxism, a community. Important here is not so much *racist* crime, but *crime* itself. That affects every one of us regardless of race or sex. Following on from his original dubious assertion, Parekh then goes on to assert that racist attacks are perpetrated 'not only *against* [emphasis in the original] a community but also, in the perception of the offenders themselves, *on behalf of* a community' (Parekh, 2000, 128). This comes very close to arguing that recently, whatever the perceptions of the offenders, when a 77-year old white man was badly beaten by Asian youths in Oldham that the non-violent and law-abiding members of the Asian population resident in Oldham approved of what happened. Possibly, some did, but many, one can assume, were disgusted by the act of violence itself regardless of the victim's race. And the same could be said of the white reaction to Stephen Lawrence's murder in 1993.

Education, Arts and Media

As inheritors of the Marxist-Leninist tradition of *agitprop*, multiculturalists pay special attention to education, the arts and the media which they consider to be the commanding heights in the anti-racist industrial complex. Parekh seems unable to envisage art and related activities independent of the state. What he has in mind here is a huge enterprise of socialist-realist propaganda subsidised by the tax payer which will then disseminate the tenets of multiculturalism. He makes explicit demands for 'redistribution of funding' in the arts (Parekh, 200, 166) and his plans for the media are the sort of thing that was commonplace in the former Soviet Union. Overwhelmingly, there is a desire to change reality by changing what we see on television.

Among multiculturalists it is an article of faith that higher education in the UK fails to take account of non-whites:

> [...] curricula and programmes of study that do not reflect Asian and black experience and perceptions; assessment regimes that are not appropriate for mature students; timetabling arrangements that are culturally insensitive; lack of sensitive pastoral support for students experiencing difficulties associated with colour or cultural racism; and a lack of Asian and black lecturers and tutors (Parekh, 2000, 148).

Any one familiar with higher education in the US will recognise the

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provenance of these demands.[4] In citing them Parekh unwittingly provides no justification for changes but a number of solid reasons why the influence of multiculturalism on the university curriculum is disastrous and something to be very firmly resisted (Bloom, 1988, Hughes, 1993, Kirk, 1994 & 1996, Windschuttle, 1997).

Consider the study of Russian language and literature. Now, one can argue about what should be included in a course of study - whether one concentrated on nineteenth century or twentieth century literature but the point remains that the subject requires long hours of study, especially when some students take a joint honours course which involves the study of a another language and literature at the same level. Irrespective of what combination of study a student pursues he must achieve a minimum level of competence in spoken and written Russian to get his degree. 'Asian and black experience and perceptions' have no relevance here at all. All students irrespective of race or sex are expected to achieve the same minimum standard. Students are able to meet these standards or they are not. The same requirements apply in other disciplines. Parekh's demand that the Asian or black perspective should be considered (what this means exactly in the field of modern languages or physics is not clear) is still further evidence of special pleading. Higher education in the US has been pursuing this course for a number of years and the result is preferential treatment for black students on entry requirements to certain courses who fail to meet minimum standards. As a result large numbers of capable white students with high SAT scores have been denied a place in a good university for which their innate intellectual abilities make them suitable (D'Souza, 1992, Bork, 1997). This most certainly is racial discrimination or racism, and of a particularly vicious kind. If poor average black performance at university is IQ-related, then this will have a limiting effect on the number of blacks who can teach at university level and in the type of disciplines taught.

Chapter 12 of *The Parekh Report*, which deals with the arts and media, begins with a citation from Jane Austen's *Mansfield Park* in which 'dead silence' is noted in response to a question concerning the slave trade in Austen's novel. 'Dead silence' then becomes Parekh's theme for this chapter. In his eagerness to castigate the English for their part in the slave trade, Parekh ignores or is unaware that slavery was practised long before the first white colonialists arrived in Africa (Baker, 1974, 364-5) and that it still flourishes today in sub-Saharan

[4] Parekh's hiring and promotion plans for the media and the arts are a direct borrowing from the federal employment preferences used in the US (Parekh, 2000, 166-167).

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Africa (Lamb, 2001). Forgetting that the UK is overwhelmingly white, Parekh has no hesitation in demanding, presumably as a way of overcoming the 'dead silence' that: 'It is essential that 'Westerners' should know far more than they do about the arts, philosophy and religions of other civilizations' (Parekh, 2000, 164). With regard to the successful prosecution of the British national interest, diplomacy and other forms of international intercourse as well as the satisfaction of intellectual curiosity, something that is not equally distributed among the population, then one might agree with the use of 'essential'. In, however, the context of a comprehensive programme designed to instill in Westerners a sense of loathing of their own civilizations, in order to weaken their resistance to the presence and consequences of large numbers of non-white aliens in their countries, the suggestion should be rejected for the social engineering it undoubtedly is.

Underlying all Parekh's discussion of multiculturalism is a deep-seated resentment of white Britain, especially the English. So the West and Westerners are placed in quotation marks or are prefaced with the inevitable and sneering 'so-called'. The intention here is to deny not just the racial basis of white Western civilization and the outstanding contributions already noted but to erase from the historical record the very idea of a distinct, separate, high-achieving white Europe. Something very similar was attempted by the Nazis with regard to the Jews. Long before the Final Solution was implemented every attempt was made to eliminate Jewish influence from German culture. Exactly the same process occurred in the Soviet Union when various national groups (Ukrainians, Volga Germans, Tartars, Kazakhs and Armenians) were deemed to be obstacles to the Soviet Union's totalitarian brand of multiculturalism. All this is, of course, in stark contrast as to how whites are expected to behave regarding Pakistanis, Indians and blacks. No 'so-called' or 'Asian' in quotation marks are permitted here. Whites are the new untouchables.

Parekh's complaints about the way in which blacks and Asians are represented in the British media and arts should be examined alongside the photographs published in *The Parekh Report* itself. The conclusions are interesting. By race the breakdown is as follows:

- 1 Asian boy, (p.9)
- 1 black woman + 2 white women, (p.17)
- 1 black man + 1 black boy + Asian boy (p.30)
- 1 black boy (p.45).

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- 1 Asian boy with graffiti "Fuck the BNP"[5] on wall in the background (p.70). Photo taken by The Association of Black Photographers
- 1 white boy with 1 white (?) girl, (p.83)
- 3 whites, immigrants?, Albanians? Status unknown. (p.98).
- 1 white woman + 1 black man (p.104)
- 6 Asian girls + 1 white woman (p.121)
- 1 black man (p.134)
- 3 Asian girls (p.155)
- 1 white male + 5 white boys (p.173)
- 1 white male + 1 black baby (p.186)
- 1 black male (p.195)
- 1 Asian male (p.209)
- 3 male figures on a building site. Race not clear. Possibly white (p.228)
- 1 black woman (p.244)
- 1 Asian woman + 1 Asian boy (p.259)
- 1 Asian male (p.275) Photo taken by The Association of Black Photographers
- 2 Black girls + 1 white girl (?). Others present. Race not clear (p.287)

- Total number of people of all races: = 48
- Total number of Asians and Blacks: = 27 (56%)
- Total number of whites including assumed Eastern European immigrants: = 21 (44%)
- Total number of whites minus assumed Eastern European immigrants: = 18 (38%)

The striking thing about these percentages is the huge under-representation of whites. Were these figures taken to be proportionally representative of the indigenous majority population as a whole, they would mean that whites comprised less than half of the population of the United Kingdom when in the year 2001 they comprise approximately 95%-96%. If we exclude the three men on page 98 who shall be assumed to be Eastern Europeans, the proportion of indigenous whites falls to a staggering 38%. Whites are the new invisibles as well. The hugely disproportionate numbers of non-whites shown are thoroughly misleading. They have more to do with the propagandistic

[5] The British National Party (BNP) is a right wing party that firmly opposes all immigration.

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ambitions of multiculturalism (note here for example the graffiti on the wall on page 70 which is the real object of this photo) than with representing an accurate picture of the UK's current racial mix. In fact, we should see these photographs more as the desired multicultural vision of the UK, a future in which whites are the minority in their own country.

Such crude socialist-realist iconography makes it all the more difficult to understand why Parekh should complain about black actors who are expected: '...'to act their skin colour' - rather than deploy the full range of their skills' (Parekh, 2000, 168). We are expected to submit to the demand to promote diversity yet when a black actor is given a role, in accordance with the diversity decree, Parekh complains, because this is 'acting his colour'. And the oft-cited reason for black failure, the lack of role models, should be borne in mind. Recall, too, Parekh's bemoaning the lack of black and Asian tutors and lecturers in higher education. If blacks are deemed to need role models in the media and in higher education, this can only be because white role models are not being accepted. If a black role model is to influence blacks he must appeal to some aspect of being black, not white. He must, as it were, 'act his colour' or 'teach his colour'. The solution, according to Parekh is 'much more colour-blind casting' (Parekh, 2000, 168). Now consider Macpherson's fury, directed at those police officers who rather quaintly believed that the law should be 'colour-blind' (see paragraphs 6.18 and 45.24 of *The Macpherson Report*), and bear in mind Parekh's own demand that diversity be given preferential treatment irrespective of the White Anglo-Saxon notion of equality before the law – colour-blind in other words – and you can grasp the scale of contempt, double standards, violence to logic, and hypocrisy on which the drive for multiculturalism is based. When colour-blind policing means that more blacks are arrested for violent crime, then colour-blind policing is obviously racist and has to go: police officers must respect diversity (ignore black criminals). On the other hand, when Parekh's television watchers perceive that black actors are acting 'their colour', colour-blind casting, but definitely not colour-blind policing, is the order of the day.

Disproportionately high levels of black crime present Parekh with another opportunity to undermine free speech. If a newspaper runs an article which produces objective and verifiable data about the disproportionate numbers of blacks arrested for violent street crime, this, according to the Parekh view, is an abuse of free speech, since it encourages racial prejudice. This is the standard contempt that Parekh can barely restrain towards white viewers and readers (and possibly some black ones as well). Parekh wants to decide what we should be

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allowed to watch because, he believes, such programming will predispose the white indigenous majority population to react in a prejudicial manner towards blacks. The trouble is Parekh might well be right in believing this but entirely wrong to criticise whites for reacting in this manner.

Assume that you are a white living in a major British city and you frequently encounter sullen, aggressive black youths on street corners and you personally know of friends who have been mugged and been subjected to racist taunts (you yourself may even have been a victim of such language and assault). You then see the Commissioner of the Metropolitan Police informing a press conference that in a recent operation and analysis of the data it was ascertained that blacks, although a minority of the population, were disproportionately responsible for street crime in London (Woods, 2000).[6] Moreover, no one, as far as one can tell, disputes the accuracy of the data. As a result of your own personal experience and observation, confirmed by acquaintances and reinforced by meticulously gathered reports with objective data, you conclude that it is definitely prudent to avoid young blacks on street corners and to plan your day in such a way that you can avoid such people at all times. You may even reevaluate your decision to stay in those many areas of London now heavily populated by blacks and Asians, seeking the relative safety of the suburbs, or leave the city and its environs altogether.

Now, as far as Parekh is concerned, if you do that you are an unreconstructed racist, the typical white bigot, whereas you are in fact merely a thoroughly rational individual who, sensible of danger, has assessed the situation and acted accordingly. 'Prejudice', as Burke warns us, 'is of ready application in the emergency' (Burke, 1790, 183). The beleaguered white Briton, living in a city which he no longer feels he can call his own, and Parekh's insistence that - if you do not like what is happening to your country, you are a racist - is just one of the unbridgeable gaps between the 'community of communities', with its institutional hatred of whites and the gruesome reality in many British cities in the year 2001. The communist party of the Soviet Union had the same problem with reality which all the tanks, secret police, psychiatric hospitals for dissidents and concentration camps could not bridge.

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[6] Woods's analysis is based on the British Home Office publication, Statistics on Race and the Criminal Justice System: A Home Office Publication Under Section 95 of the Criminal Justice Act 1991, 1999 and www.homeoffice.gov.uk/rds/index.htm.

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When indigenous Britons reject the 'community of communities' fantasy, the next step has become coercion and the restriction of their rights to free association, to assert their identity, history, culture and language and their rights to free speech. Whites, remember, are to be *made to believe* that multiculturalism is doubleplusgood. Not only does Parekh support the view that free speech can be sacrificed if the multicultural programme is not to be put at risk, but in true neo-Marxist fashion he wishes to criminalise the act of speaking out against multiculturalism. Marx and Lenin would certainly have approved of this attempt to use the very openness of England's institutions to destroy England. For ever since Lenin wrote *What is to be Done?* (1902) and countless left-wing totalitarians have enriched it, the infiltration and capture of established institutions has been the standard approach employed to subvert, to destroy and to reinvent a state along communist lines. The approach and methods remain unchanged and readily lend themselves to serving the agenda of multiculturalism or race Marxism.

Immigration

Sheer numbers alone, quite apart from racial and cultural differences, mean that legal and illegal immigration has profound consequences for a small, already densely populated island and that at some stage governments will have to act to stop the influx of immigrants. Presumably, even Parekh can see that the size of Britain necessarily means that limits to immigration must be set if the infrastructure is not to collapse and the countryside lost under concrete. Environmental groups in the UK are strangely silent on this latter point.

Rather than making the obvious tactical concession that 'Immigration and asylum controls are needed' (Parekh, 2000, 221) and then hurrying on to the next anti-white measure, Parekh should spell out why immigration and asylum controls are needed. Numbers are absolutely crucial. How far are we expected to see the population rise before we declare a critical threshold beyond which we will not tolerate more immigrants, 60,000,000, 80,000,000, 100,000,000, 120,000,000? That Parekh bypasses this issue, as with that of race, is because an open discussion of why immigration and asylum controls are needed would make another formidable case *against* immigration and thus a rejection of one of the report's central points, namely that large-scale immigration is inherently a good thing.

That Parekh's concession is purely tactical can be seen from the following:'Our recommendations are designed to shift UK (and ultimately EU) policy away from the overt or implicit racist base on which it was developed, and towards a system that reflects and endorses

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the kind of society outlined in part 1 of this report' (Parekh, 2000, 221). These recommendations are designed, quite deliberately, to allow large numbers of immigrants (predominantly non-white) to enter the white nation states of Europe with the long-term aim of changing the racial composition irreversibly in favour of non-whites. It goes without saying that such breathtaking multicultural engineering, cannot be permitted to be derailed by anything as crude as the wishes of Europe's white indigenous populations, who do not want immigration and asylum controls to be abandoned because they know that their countries will not survive the influx of large numbers of foreigners. The spirit of apartheid lives on in multiculturalism: apartheid forcefully separated the races, whereas multiculturalists seek to impose racial and cultural mixing on homogenous populations regardless of the social, moral and economic consequences. Which is worse?

Despite the many assertions from politicians of all parties that immigrants, and the supposed benefits of "diversity" that accompany them, are a good thing, there is no demand for more "diversity" on the part of whites. Indeed, the reverse is true. Not on the same scale as in the US, there is now a recognizable manifestation of white flight to the countryside and the suburbs in the UK. America provides more clues as to what the UK can expect if high levels of non-white immigration continue for another decade or more: much higher levels of violent crime; a huge increase in taxes to fund welfare programmes; an overwhelmed criminal justice system; loss of amenity and environmental destruction, especially acute in the south east of England. The American experience also makes it quite clear that whenever they can escape or circumvent oppressive federal legislation, blacks and whites will segregate themselves along racial lines. The periodic eruptions of race-related violence which we have seen in British cities would become much worse in scale and duration, as the numbers of non-white immigrants increased. Oldham, not the sickly utopian Parekh fantasy of a 'community of communities', would be the symbol of the new, strife-torn Britain. Now is the time to avert this catastrophe and the point to bear in mind is that it can be averted. It is not inevitable. It is above all a question of political will.

The UK does not have an open-ended obligation of any kind to allow foreigners (black or white) for whatever reasons to come here and live. The primary obligation of the British government is to safeguard the way of life of the majority (overwhelmingly white) and to secure the nation's physical boundaries from armed invasion. And here we can identify an affliction peculiar to the Western mind. All the research and development costs allocated to National Missile Defence (NMD) and

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the costly infrastructure needed to deal with the threat of Strategic Information Warfare (SIW) count for nothing if the state that disposes of such weapon systems has meanwhile voluntarily and suicidally relinquished control of its borders, so acquiescing to an unarmed invasion of legal and illegal immigrants. The vast majority of people in the UK want to see the numbers of immigrants reduced and illegals expelled. In view of the moral and intellectual failure of Parekh and many British politicians to make the case for immigration that is a perfectly rational and respectable position to hold. The onus is not on the white indigenous majority population to deploy rational arguments against large-scale immigration into the UK - though such arguments can easily be mustered - but on the pro-immigrationists and multiculturalists to justify why they wish to disunite and to balkanise the UK by importing large numbers of legal and illegal immigrants. So far their attempts have been pitiful in the extreme.

Conclusion

Sponsored by a strange combination of white liberals who reject their country and recent immigrants who seem driven more by a desire to punish Britain for her past greatness, particularly where it concerns empire east of Suez, *The Parekh Report* is less a blueprint for creating a 'community of communities', to use one of Parekh's favourite expressions, than an attempt to impose an alien agenda on the British people for which no major party has any mandate at all, let alone the Runnymede Trust (a nasty irony in view of the importance of Runnymede in English history).

One of the crucial questions arising from this report is whether race is a social and political construct or a biological and genetic reality. Whatever one's view conflict is to be expected if the multicultural agenda, as envisaged in *The Parekh Report*, is even partially implemented. The proposed declaration on cultural diversity is especially offensive in an overwhelmingly white country where blacks and Asians have only lived in noticeable numbers since 1948. One wonders what Robert Mugabe's reaction would be, were white farmers, Zimbabwe's beleaguered wealth creators, to make such a suggestion in that unhappy land.

Even if race were a 'social and political construct', as Parekh insists, though, as noted, he fails to provide any works in the secondary literature to support his belief, this would still not invalidate the desire of the 'socially and politically constructed' white population to retain their own particular social and political construct known as the United Kingdom. Even social and political constructs are not built in a day.

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Parekh's expectation that the white majority population abandon their historically established social and political construct in favour of his is thoroughly unjust and, in view of the nature of his recommendations regarding what he calls "hate crime", deeply threatening to all the freedoms constructed by all these little Englanders, emulated, incidentally, worldwide. 'Albion's seed', in David Hackett Fischer's striking phrase, has born remarkable fruit and not just in North America. Another alarming consequence of race's being a social and political construct is that the mission of the United Kingdom's Commission for Racial Equality (CRE) must extend way beyond racial equality. It means, given the way in which race is defined, that the CRE is, by default, also committed to *imposing* social and political equality. This does not mean anything so crass as equality before law: it means equal outcomes. In the twentieth century this was known as communism. We are, it seems, slow to learn.

In attempting to compel the white British to believe that they are just a social and political construct and that this construct must be deconstructed to make way for another, Parekh is, in fact, asserting that a multiracial, social and political construct is not merely on a par with, but *superior* to, the traditional, mono-racial, British one he wishes to "deconstruct" and replace. In other words, he is behaving like one of those old-fashioned British "racist" empire builders whom he excoriates for taking up, as Kipling famously put it, the white man's burden.

If Parekh believes that multicultural societies are deemed to offer the world a privileged perspective, then there can be no objections to white Britons holding the view that Britain, as it has evolved over the centuries, is also a privileged perspective, and one to be protected not to be "deconstructed" by social engineers and foreigners. Recasting the problem as a social and political construct, as Parekh does, may divert attention from race, as a genetic and biological reality - for the time being and not for much longer - but solves nothing because the fundamental causes of conflict in multicultural (multiracial) societies are ignored. Consider, too, that the flow of legal and illegal immigrants from India, Pakistan, sub-Saharan Africa and Eastern Europe is unidirectional. The reasonable assumption has to be that these immigrants also believe that white Britain has something to offer them that is vastly superior to the grand corruption, squalor, incompetence, disease, superstition, endless tribal and civil wars, murderous rulers, overpopulation and environmental degradation of their own benighted countries. Indeed, how can it be otherwise? As far as one can tell, whites are not storming India's borders or those of South Africa.

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Multiculturalism is also conspicuously one-sided in that the demands made of the British and other European nation states to deconstruct themselves in order that they accommodate large numbers of aliens do not to apply to China, Japan, Mexico, India, Kenya, Zimbabwe, South Africa and Somalia. This has been thoroughly, and for people such as Parekh, embarrassingly well documented by Peter Brimelow in his pioneering study, *Alien Nation*. Brimelow wanted to ascertain what would happen were one so minded to emigrate to one of the countries that provide the bulk of immigrants to the US (Mexico, South Korea, Philippines, Taiwan, Jamaica, China and India). Brimelow's favourite response was that from the Indian embassy.

> Three separate officials asked him whether he was of Indian origin, one making it quite clear that: 'Since you are not of Indian origin, while it is not impossible for you to immigrate to India, it is a very difficult, very complex, and very, very long process. Among other things, it will require obtaining clearances from both the Ministry of Foreign Affairs and the Ministry of Home Affairs. (Brimelow, 1996, 253).

As Brimelow observes: 'Note that these Indian officials are asking not about *citizenship*, but about *origin*. For those unaccustomed to recognizing such things, this is racial discrimination. It is even more stringent than the 1921 Quota Act – an outright "brown-India policy".' Brimelow concludes that: '*The world is laughing at America*' (emphasis in the original, Brimelow, 1996, 253). And Parekh wants the world to laugh at the United Kingdom as well.

Fissiparous and predisposed to conflict, multicultural states offer unprecedented opportunities for an unaccountable and unelected stratum of race bureaucrats to regulate the lives of the majority. Nothing less than the transformation of traditionally white, homogeneous, Western nation states into multiracial societies will satisfy Parekh. Love of nation and allegiance to ancient standards of genuine community block the path towards this transformation. Powerful feelings of love and belonging have to be eradicated if multiculturalism's goals are to be achieved. History, language and the-way-we-do-things have to be destroyed or corrupted. In the pursuit of these goals, Parekh and others are fully aware that persuasion will not work, hence the coercion and oppressive nature, or rather anti-nature, of multiculturalism. It is a new and particularly virulent form of oppression. Too many of the indigenous population, have been slow to realise just how virulent, or they prefer to look away or run away. And it is well advanced. So fundamentally opposed is *The Parekh Report* in both the spirit and substance of its message to the United Kingdom's

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indigenous majority population that one might easily conclude it was written by the agents of a would-be occupying power and their collaborators. Multiculturalism, like its Marxist-Leninist predecessors, is showing itself to be preeminently the cult of the nation killer not the nation builder. What is happening in Britain may well be replicated in numerous other of the West's nation states in the years ahead.

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Diversification as a Corporate Strategy for a Family-Controlled Business Group in a Frontier Market

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This study focuses on a family controlled firm "Beximco Group" in a frontier market economy, which during its thirty-five years of existence, has grown to become the leading business organization in Bangladesh. In this study, we look at the gains obtained via diversification in a setting that is completely different from the Western world. Bangladesh is a country that has been characterized as a "Frontier market" by the IFC, a subsidiary of the World Bank. Most of the ideas reflected in the literature are from studies done in the US. The broad ranges of institutional features that support business activities in the West are all absent in Bangladesh, and the findings in the literature may not be a practical application for emerging market economies and frontier markets, which are a step behind emerging markets. Devoid of all the institutional facilities and features that the West offers in the corporate world, we find that diversification leads towards growth and value creation in Bangladesh. Using accounting and market information from Audited Financial Statements from 1983-1995 and the IFC's EMDB data, we document that Beximco Group has made significant progress towards the path of growth and value creation. The findings support the hypothesis of growth through diversification. This result is consistent with that of Khanna and Palepu (1997) who observe similar findings for emerging market economies such as Chile and India. Baker (1992) notes that the role of diversification for the growth of Beatrice from a small creamery firm to one of the largest conglomerates in the US, is similar to what we see today for Beximco's growth. Diversification played a leading role for the rise in prominence for the group in Bangladesh.

Key Words: Diversification, Bangladesh, Emerging Market Economies, Family-controlled businesses.

1. Introduction

Does diversification pay off? This question will be examined in the context of a frontier market economy within a founding-family controlled firm. International Finance Corporation (IFC), a subsidiary of World Bank, defines a "Frontier market" as a relatively small and

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illiquid market, even by emerging market standards, where information is generally less available than in other markets. The IFC also considers whether a market has adequate turnover and listings, and whether it has drawn at least a few foreign investors' interest. Another consideration is a market's development prospects, and in particular whether it is likely to eventually have the breadth (e.g., listings), depth (e.g., market cap and turnover), and infrastructure (e.g., regulatory structure, custody, clearance, and settlement). The Bangladesh market by the IFC's selection criteria qualifies for the "frontier market" status.

In the United States there has been quite a few studies in this area. During the 1950's and 1960's, many corporations undertook massive diversification programs. This process reached its climax with the merger wave of the late 1960's and the accompanying rise to prominence of huge conglomerate firms. In the 1960's and 1970's, conglomerates were viewed as companies that can operate unrelated businesses more efficiently than a business that can be operated as a stand-alone unit, and were able to organize internal capital markets that were more efficient in allocating resources than external markets. In the last 15 years the trend has reversed, and recent studies by Comment and Jarrel (1994) and Liebeskind and Opler (1993) document return to specialization.

The characteristics of the diversified business group can be summarized as follows: The business interests are diverse. The control system can take diverse forms depending on the conditions of each country. The controlling party—the conglomerate headquarters, the holding company and the head office—influences the allocation of capital into new ventures and existing firms. The control power resides exclusively inside the group whether it is perfectly owned, as in conglomerates, or partially owned, as in listed group member firms. Outside participation in control is restricted due to the concentrated ownership.

Many different explanations have been proposed for the existence of diversified business groups (Ghemawat and Khanna 1998). First, the multi-market presence of groups may leverage them market power in individual markets. Second, the group structure can facilitate the sharing of common resources (supplier relationships, technology, customers) across businesses. Third, the group structure may be a privately motivated economic response to induce policy favor. Fourth, groups may coalesce around more generalized resources in the unavoidable conditions of market imperfections in capital and labor markets.

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Internal capital markets can exert a strong monitoring. Gertner et al.(1994) provide a formal model of this benefit. In the model, internal versus external capital market is distinguished according to equity type and debt type. The owner provided internal capital market leads to more monitoring than does the outside capital market that is usually provided with debt-type capital. Stein(1997) focuses on the choice of projects made by a conglomerate' s headquarters. When credit rationing is strict due to information asymmetry, the internal capital market can create value by picking winners among the competing projects. Unlike the conglomerates in the US where the internal capital is allocated within a single business entity, the group structure in many countries is composed of legally independent entities. So the internal reallocation of capital in business groups may be more restricted than that in conglomerates. However, groups can transfer funds among member firms by using intra-group debt and equity participation.

Internal capital markets can create value by easing the financial constraints of the outside capital market (Lewellen 1971). Unlike independent firms focusing on perfectly correlated projects, diversified business groups can reduce the viability of cash flows and smooth the returns of not-perfectly correlated projects. This coinsurance effect can increase both the outside debt capacity and the outside equity capital. When a borrower can cross-pledge the incomes of various projects, he/she can use the incomes of successful projects as collateral for other projects. However, perfectly correlated projects cannot be used as collateral and cannot increase debt capacity. Internal capital markets can also reduce the cost of outside equity financing. In some developing countries, where market imperfection seems to be severe, the diversification discount has proved to be low or not to exist. (Claessens et al. 1999, Rajan and Zingales 1998b, Fauver et al. 1999)

There are costs to internal capital market as well. First, the internal allocation of capital may cross-subsidize inefficient projects and over-invest in unprofitable projects. Scharstein and Stein(1997) modeled divisional rent seeking and inefficient investment. If the headquarters are also an agent of outside investors, it may provide preferential capital budgeting to divisions to limit division managers' unproductive rent seeking, rather than grant cash. Second, a different cost of internal capital markets is related to the increasing cost of monitoring as the scope of diversification becomes wider. As the scope of diversification increases, the marginal cost of monitoring increases due to increased internal monitoring with added hierarchies. The increased costs of monitoring in the multi-layered hierarchy might be reduced by rendering the 'real authority' to the subordinated and giving them

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'initiatives.' Without organizational innovation in the diversified business groups, the increased costs of monitoring limit the upper bound of scope.

This focus apparently results from the view that unrelated diversification reduces firm value. In this study, we show that diversification plays a leading role towards value creation for a family owned group in a frontier market economy where the institutions' infrastructures and facilities are completely different than those in developed markets.

Our paper is organized in the following manner. Section II presents the literature review, and Section III discusses Beximco's operations and investments opportunities, and the role of Dhaka Stock Exchange (DSE) and security and exchange commission (SEC) for the development of a stock market in Bangladesh. Section IV discusses the differences of Institutions' structures between Bangladesh and the Western World. Section V presents data and methodology, and Section VI the empirical results. Section VII provides the final conclusions and comments.

2. A Comprehensive Literature Review

Chandler (1977) argues that, because multidivisional firms create a level of management concerned with coordination of specialized divisions, they are inherently more efficient and thus more profitable than their lines of business would be separately. Weston (1970) states that resource allocation is more efficient in internal than in external capital markets. Weston also contends that diversified firms allocate resources more efficiently because they create a large internal capital markets. Arguments in favor of internal capital markets predict that diversified companies have greater positive net present value investments than their segments would have as separate firms. Another potential benefit of diversification arises from combining business with imperfectly correlated earning streams. This coinsurance effect gives diversified firms greater debt capacity than single line of business of similar size as documented by Lewellen (1971). One way in which increased debt capacity creates value is by increasing interest tax shields. Thus, diversified firms may have higher leverage and lower tax payments than their businesses would have if operating separately.

Majd and Myers (1987) note that undiversified businesses are at a significant tax disadvantage because tax is paid to the government when income is positive, but government does not pay the firm when income is negative. However, this is somewhat reduced, but not eliminated, by carry back and carry forward provisions in the tax code. Majd and

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Myers' analysis concludes that as long as one or more segments of a conglomerate experience losses over a few years, a conglomerate pays less in taxes than its segments would pay separately.

Williamson (1975) argues that the internal capital markets supplied by the corporate staff of diversified firms have information advantage over external markets. Stein (1997) finds that when headquarters have the power to actively shift funds from one project to another, internal markets may indeed function more efficiently than the external capital markets. Internal capital markets may also be better suited to deal with information that is strategically valuable to the firms. Also, the hierarchical structure of the firm may allow management to act more effectively on the information they possess concerning new investment opportunity than outside investors. Another potential benefit of diversification is the ability to access financial markets. If financial markets are imperfect, specialized firms might face greater obstacles exploiting investment opportunities as specialized firms have more trouble raising funds.

Diversification can create several costs. Stulz (1990) argues that diversified firms will invest too much in lines of business with poor investment opportunities. Mayer, Milligram and Roberts (1992) predict that an unprofitable line of business creates greater value loss in conglomerates than they would as stand-alone firms. Jensen (1986) offers an alternate hypothesis concerning the merits of an internal versus external capital market. He argues that internal capital markets grant discretionary control over financial resources that can turn into a disadvantage for stockholders. It results in conflicts of interest when mangers follow their own self-interest and use the free cash flows generated by prosperous divisions to prop up failing divisions or simply over invest. Miller (1995) argues that the break-up of conglomerates often increases value. Spin-offs and other forms of corporate reorganization lead to more gains. Miller's arguments are based on a US setting.

Lang and Stulz (1994) and Berger and Ofek (1993) have found that during the 1980's diversified firms sold at significant discounts relative to more focused firms. On the other hand, Mark Shleifer and Vishny (1990) show that the market reacted negatively to unrelated acquisitions during the 1980's, but not during the 1970's. Copeland and Weston (1979) cite several studies that find superior stock performance by conglomerates over mutual funds in the 1960s and early 1970s. Other studies find inferior performance during this period. Ravenscraft and Scherer (1987) argue that performance of a sample conglomerate becomes noticeably worse if the 1970s are included. De (1992), however,

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finds no cross-sectional correlation between the degree of focus and measures of excess return calculated over the period 1976-85.

A firm's intangible assets include organizational capital, reputational capital, monopolistic rents, and investment opportunities. Management's actions directly affect the value of these intangible assets. Managerial entrenchment can be viewed as an intangible asset that has negative value. Management can add or subtract from the value of firm's tangible asset and since Management is responsible for firm's investments, it can add or subtract value by choosing the right or wrong portfolio of a firm's activities. Management scholars have argued for long that there is a relationship between institutional context and organizational form (Williamson (1991), Hill (1995), Nee (1992) and Hamilton (1996)). Khanna and Palepu (1997) draw upon this sizable literature on business group, to arrive at the proposition that the institutional context is important in determining the extent to which diversified business groups create or destroy value.

Karl Lins and Henri Servaes (1997) examine international evidence on the value of corporate diversification in three countries, the UK, Germany and Japan, to determine if companies in these countries have been able to overcome the agency cost associated with diversification, and therefore have been able to enhanced shareholder wealth in the process of diversifying. The institutional environment in Germany and Japan is very different from the one in the US, while that of the UK is similar to the one of the US. As a result, this environmental difference many have suggested that agency problems may be less severe in these countries. Overall the authors find that the institutional structure of a country is related to the value of diversification, however, no consistent pattern emerges across countries.

Khanna and Palepu (1997a) write that focus strategy and core competencies, now practiced in the West may not be a suitable option in the emerging markets. While managers in the West have dismantled many conglomerates assembled in the 1960s and 1970s, the large diversified business group remains the dominant form of enterprise throughout many emerging markets. Focus maybe a good advice in West, which functions under a range of institutional that supports business, such institutional support are not available in the emerging markets. Companies therefore must adapt their strategy to fit their institutional context: a country's product, capital and labor markets, and its regulatory systems. Emerging markets suffering from weak institutions and conglomerates can add value by imitating the functions of several institutions that are present in the West. The corporate mantras of the West may not be a viable prescription for the emerging

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markets or the frontier markets that are even a step behind the emerging markets.

Berger and Ofek (1995) study the effects of diversification on the firm value by estimating the value of a diversified firm's segments as if they are operated as separate firms. Over investment is associated with lower value for diversified firms, and that segments of diversified firms over invest more than single line business. These results are consistent with one source of the value loss, being the greater propensity of multi segment firms to over invest. The subsidization of poorly performing segments also contributes to the value loss from diversification. This conclusion is further cemented by documenting that the segments of diversified firms have lower operating profitability than single line business. The study also confirms that there are two potential benefits of diversification. One is the increased interest tax shield resulting from higher debt capacity and the other the ability of multi-segment firms to immediately realize tax savings by offsetting losses in some segments against profits in others.

Lang and Stulz (1994) investigate whether the market's valuation of a firm is correlated with its degree of diversification. If diversified firms differ from specialized firms only because diversification improves performance, one would expect diversified firms to be valued more than comparable portfolios of specialized firms. The evidence from their study is supportive of the view that diversification is not a successful path to high performance, but less definitive on the question of the extent to which diversification hurts performance. They find no evidence that demonstrates that diversification benefits on average.

Dial and Murphy (1995) conduct a clinical study of compensation and strategy at General Dynamics. They examine the General Dynamics compensation system and document its role in determining and achieving GD's corporate objective. In 1991, with the end of the Cold War, defense contractor General Dynamics Corporation (GD) faced declining demand in an industry saddled with excess capacity. At the time when the other defense contractors have made defense related acquisitions or diversified into non-defense areas, GD adopted an objective of creating shareholder value through downsizing, restructuring and partial liquidation. The study shows how incentives assist in shaping strategy, the political cost and economic benefits of downsizing and demonstrates that even firms in declining industries have opportunities for value creation.

Martin, Gillan and Kensinger (1997) provide clinical evidence of the wealth effects of Sears' restructuring. Sears' high profile throughout the eighties and early nineties offers a unique opportunity for an in-depth

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study of two broad sets of issues: the economic rationale for management's decisions and the associated shareholder wealth effects. Sears' restructuring is no less dramatic than those that resulted from 1980s leveraged buyouts, and it produces similar results in terms of enhanced shareholder value. However, in the case of Sears, the benefits accrue directly to stockholders. Though the results of the event study conducted by the authors indicate that investors responded positively to the initial announcement of the acquisitions, the performance of the combined portfolio of business is significantly below what an investor could have earned by investing in a comparable risk portfolio of industry-matched firms. In short, homemade diversification at the investor level outperforms Sears' corporate diversification program.

Growth through diversification is chronicled by Baker (1992) in his study of the history of the Beatrice company from its founding in 1891 as a small creamery, through its growth by acquisition into a diversified consumer and industrial products firm and its subsequent leveraged buyout and sell off. The author analyzes and gives reasons and consequences of the acquisition and divestiture policies, organizational policies and governance. Baker concludes that too much centralization and weak corporate governance are the reasons for Beatrice's downfall, and highlights the importance of organizational structure and governance in the creation of economic value.

McConaughy, Walker, Henderson and Mishra (1997) probe the effect of managerial ownership and founding family control upon efficiency and value. Public founding family controlled firms (FFCFs) represent an organization between the diffusely owned, manager-controlled firm and the closely-held private firms. The unique relationship between the founding family CEO and the firm holds the potential for improved monitoring and top managerial incentives. The authors attempt to relate managerial ownership with both firm value and performance and apply both firm value and operational efficiency measures in order to provide a context to explain differences in firm value. Founding family controlled corporations have lower agency costs while controlling for managerial ownership levels, size and industry. Among non-FFCFs control for size and industry, and higher managerial ownership levels are associated with higher agency costs suggesting managerial entrenchment. The FFCFs' employees are significantly more productive in terms of sales and cash flow per employee. FFCFs have higher sales growth, and gross, net operating cash flows margins are significantly higher. All of these evidences lead to a significantly high firm value as measured by market to book equity. The authors suggest that it is the relationships, rather than just the level of managerial

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ownership, that are significant in explaining corporate value and efficiency.

Fama and Jensen (1983) suggest that family relationship between managers and owners may reduce agency costs because the multi-dimensional, long-term nature of the relationship allows improved monitoring of the decision agents. De Angelo and De Angelo (1985) write that family involvement serves to monitor and discipline managers. The incentive for family monitoring is ultimately traceable to explicit and implicit contracts that tie family welfare to company profitability through the quasi-rents the relatives earn from employment at a family controlled firm and through family ownership of common stock cash flows.

Jensen and Meckling (JM) (1976) bring the issue to the forefront of financial economics. They argue that the value of the firm is positively related to the level of managerial ownership because of reduced agency costs. JM contends that the firm reaches a maximum value when the owner manager own all of the firm's equity and considers ownership an exogenous factor that affects the value of the firm. However, the JM position is not universally accepted. Demsetz (1983) and Demsetz and Lehn (1985) argue that the level of managerial ownership is endogenous to the firm. Since the optimal level of managerial ownership depends on such factors as firm size, regulation, and risk, the level of managerial ownership does not affect firm value.

Stulz (1988) refines the JM argument, hypothesizing that managerial ownership in excess of 50% of the firm value insulates managers from hostile takeover and results in a curvilinear relationship between managerial ownership and firm value; value initially rises as ownership becomes more concentrated and then falls due to management's insulation. Empirical evidence does not resolve the issue. Demsetz and Lehn (1985) find no significant relationship between the firm value and managerial ownership level.

Several studies compare the performance of diversified firms to specialized firms and also diversification in an international setting in developed countries to the setting in the US, but none have reached a decisive conclusion. Some evidence suggests that the value of diversification is related to the institutional structure of the country, but nothing concrete emerges. Another thought that come out of the literature is on M&A as part of diversification plan produces wealth loss rather than gain. The empirical studies have generally produced mixed results on diversification's overall value effect. No definite conclusion can be reached to support or to reject the hypothesis that diversification can create value for the shareholders. On a time frame scale, we see that

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at one point of time, diversification did pay off, leading to growth value creation, but later on diversified firms turn out to be a "white elephant" and gradually the trend shifts from diversification towards specialization or focused operations.

Clinical studies indicate that diversification may not be the answer to create wealth as in the case of Sears, but other study like Ramirez's (1995) analysis of House of Morgan and Baker's (1992) study on diversification and re-diversification of Beatrice shows that diversification pays off at one point of time. Some plead that diversification has both value enhancing and value reducing effects. The potential benefits of operating different lines of business within one firm include greater operating efficiency, less incentive to forego positive net present value projects, greater debt capacity and lower taxes. On the other side, the potential costs of diversification include the use of increased discretionary resources to undertake value decreasing investments, cross-subsidies that allow poor segments to drain resources from better-performing segments and misalignments of incentives between central and divisional managers.

Most of the literature is from studies done in the US, and based on the settings of the US. In this study, we look at the gains obtained via diversification in a different setting than the US, Bangladesh, where the terminology like M&A, corporate raids, sell off, spin-offs, buyback and stock market reaction are still non-prevalent. There lies the difference between the West and Bangladesh. The broad range of institutional features that support business activities in the West are all absent in Bangladesh. The findings in the literature may not be a practical application as in the case of Bangladesh. Devoid of all the institutional facilities and features that the West offers to the corporate world, diversification may be the answer for growth and value creation at this point of time in a thin inefficient market like Bangladesh.

3. Diversified Business Groups and the Beximco Groups of Bangladesh

3.1 Diversified Business Groups in Developing Countries

Various types of business groups exist in the world. One extreme is the conglomerate in the US which is composed of diverse segments under one holding company. The other extreme is the Japanese Keiretsu, whose member firms are independently managed in various sectors and loosely connected. The Keiretsu member firms are also connected with the main banks. The ownership structure of the member firms is characterized by mutual shareholding and financial institutions'(banks and insurance companies) shareholding. Between these two extremes,

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there exist various types of groups, which depend on the country's legal, social and financial conditions. (Ghemawat and Khanna 1998, Khanna and Palepu 1999, Claessens et al. 1999, Chandler et al. 1997).

In Appendix 1, the relative size of the leading groups in each country is provided. The leading groups' sizes (sales relative to GNP) are rather striking. The largest corporation in the world-General Motors in the US, with sales of US$ 125,126 Million and 761,400 employees accounted for just 2.2% of the US GNP in 1990. In Indonesia, Taiwan, Hong Kong, and Korea, the size of the leading business groups relative to each GNP is over 4%. The Korean case is rather extreme. Even if we consider general trading companies which are not common outside Japan and Korea, and which usually account for about 30-40% of the groups' sales in the Korean Chaebol, the size of the business group in Korea is enormous.

Not only the leading business group, but the business groups as a whole, share a significant part of the national economy in many countries. In India, companies affiliated with groups accounted for 89% of the total sales and assets of all the publicly traded Indian companies in the private sector in 1993 (Ghemawat and Khanna 1998). In Japan, eight horizontally-connected groups (Mitsubishi, Mitsui, Sumitomo, Fuyo, DKB, Sanwa, Tokai, IBJ) held 17.4% of Japanese total sales, 22.1% of Japanese net profits, and 6% of Japanese employment in 1992 (Dodwell Marketing Consultants 1993). The thirty largest business groups in Korea accounted for 13.53% of total value added, 44.32% of total sales, 21.93% of net profits and 4.16% of employment in 1992 (Choi 1998). In Taiwan, the 101 identified business groups' total sales relative to GNP in 1992 was 35.52 % and the share of employment was 5.05% (China Credit Information Service 1995).

The number of affiliates and subsidiaries in each group is large and the scope of the business is very diverse. For example, the Formosa Plastic Group in Taiwan, with 17 firms, has business interests in plastics, chemicals and fiber, plywood and lumber, transportation, textiles and spinning, electronics, hospitals and education (China Credit Information Service 1995). The biggest Indonesian group, the Salim group, has entered various sectors including textiles, food and consumer products, cement, automobile, wood and wood products, steel, chemicals, agriculture, banking and real estate (Sato 1993).

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Table 1A

Beximco Group Performance [Tk{Taka} (in million)]

This table presents the Group's performance from 1983-1995.

Table 1 figures are compiled from the audited annual statements for the Group from 1983-1995. Units indicates the number of companies in operations yearwise.

Year	Units	Sales (Tk)	Total Assets (Tk)	Net Income (Tk)	Debt (Tk)	Equity (Tk)	Total Expense (Tk)
1983	10	460.9	417.5	5.05	379.29	38.21	455.85
1984	11	517.55	554.82	15.08	474.02	80.8	502.47
1985	13	700.95	712.91	9.46	622.38	90.53	691.49
1986	13	884.53	815.97	-32.67	688.74	127.23	917.2
1987	15	1068.97	1025.1	40.22	861.09	164.01	1028.75
1988	13	1478.15	1057.15	18.09	856.71	200.44	1460.06
1989	13	2022.67	1308.7	1.26	1122.92	185.78	2021.41
1990	13	2855.69	2139.0	25.52	1727.61	411.39	2830.17
1991	14	2970.73	2656.1	97.81	2029.16	626.94	2872.92
1992	14	2943.46	3428.91	202.68	2592.83	836.08	2740.78
1993	15	3596.77	5742.29	221.06	4068.63	1673.66	3375.71
1994	16	5532.19	11383.95	654.69	6666.79	4717.16	4877.5
1995	20	7207.51	18385.3	551.87	9602.44	8782.86	6655.64

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Table 1B

Beximco Group Performance

Table 1B shows the annual changes (%) from Table 1A for the period from 1984-1995

Year	Change in Annual Sales %	Change in Annual TA %	Change in Annual NI %	Change in Annual Debt %	Change in Annual Equity %	Change in Annual TE %
1983	0	0	0	0	0	0
1984	12.291	32.891	198.614	24.976	111.463	10.227
1985	35.436	28.494	-37.268	31.298	12.042	37.618
1986	26.190	14.456	-445.349	10.662	40.539	32.641
1987	20.852	25.630	-223.110	25.024	28.908	12.162
1988	38.278	3.127	-55.022	-0.509	22.212	41.926
1989	36.838	23.795	-93.035	31.074	-7.314	38.447
1990	41.184	63.445	1925.397	53.850	121.439	40.010
1991	4.028	24.175	283.268	17.455	52.396	1.511
1992	-0.918	29.096	107.218	27.778	33.359	-4.600
1993	22.195	67.467	9.068	56.919	100.179	23.166
1994	53.810	98.248	196.159	63.858	181.847	44.488
1995	30.283	61.502	-15.705	44.034	86.190	36.456
Mean	26.706	39.360	154.186	32.202	65.272	26.171

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Table 2

Beximco Group 1983 - 1995.

This table presents the year-wise breakdown of total units in operation in different sectors and with number of units in each sector.

Shows the Growth of the Group from 1983-1995.Yearwise division

break down shows the how diversification in different sectors has taken place.

Year	Textile	Chemical	Real Estate	Trading	Jute	Marine Foods	Others	TOTAL
1983	0	2	0	1	5	2	0	10
1984	0	2	0	2	5	2	0	11
1985	1	2	0	2	5	2	1	13
1986	1	3	0	1	5	2	1	13
1987	1	4	0	2	5	2	1	15
1988	1	3	0	2	4	2	1	13
1989	1	3	0	2	4	2	1	13
1990	2	2	0	2	4	2	1	13
1991	2	2	1	2	4	2	1	14
1992	2	2	1	2	4	2	1	14
1993	2	3	1	2	4	2	1	15
1994	3	3	1	2	4	2	1	16
1995	6	3	2	2	3	2	2	20

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Table 3A

Beximco Group Financial Accounting Ratios 1983 - 1995.

This table shows the financial ratios. Asset turnover is Net Sales over Total Assets. Return on Assets is Net Income over Total Assets. Profit Margin is Net Income over net Sales, while Return on Equity is Net Income over Equity.
Debt to Equity is Debt over Equity and Debt to Asset is Debt over Total Asset.

	Operating Ratio	Profitability Ratio			Debt - Management Ratio	
	Asset turnover	Return on Assets	Profit Margin	Return on Equity	Debt to Equity	Debt to Asset
Year	NS / TA	NI / TA	NI /NS	NI / EQUITY	DEBT / EQUITY	DEBT / TA
1983	1.104	0.0121	0.0110	0.1320	9.9260	0.9080
1984	0.933	0.0272	0.0291	0.1870	5.8670	0.8540
1985	0.983	0.0133	0.0135	0.1040	6.8750	0.8730
1986	1.084	-0.0400	-0.0369	-0.2570	5.4130	0.8440
1987	1.043	0.0392	0.0376	0.2450	5.2500	0.8400
1988	1.398	0.0171	0.0122	0.0900	4.2740	0.8100
1989	1.546	0.0010	0.0006	0.0070	6.0440	0.8580
1990	1.335	0.0119	0.0089	0.0620	4.1990	0.8080
1991	1.119	0.0368	0.0329	0.1560	3.2370	0.7640
1992	0.858	0.0591	0.0689	0.2420	3.1010	0.7560
1993	0.626	0.0385	0.0615	0.1320	2.4310	0.7090
1994	0.486	0.0575	0.1183	0.1390	1.4130	0.5860
1995	0.392	0.0300	0.0766	0.0630	1.0930	0.5220

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Table 3B

Beximco Group Univariate Regression

This table presents univariate regession results with UNITS as independent variable and ratios as the dependent variable.

Dependent Variable ROA

D - W statistics	Variable	Coeff	Std Error	T-Stat	Sig Level
1.75216	UNITS	0.00175	0.00049	3.05953	0.00368

Dependent Variable ROE

D - W statistics	Variable	Coeff	Std Error	T-Stat	Sig Level
2.29036	UNITS	0.00709	0.00253	2.80582	0.01587

Dependent Variable PM

D - W statistics	Variable	Coeff	Std Error	T-Stat	Sig Level
1.532067	Constant	-0.10807	0.05396	-2.00282	0.07046
	UNITS	0.01022	0.00384	2.26593	0.02222

Dependent Variable ATO

D - W statistics	Variable	Coeff	Std Error	T-Stat	Sig Level
0.461164	Constant	2.26397	0.44609	5.07511	0.00036
	UNITS	-0.09181	0.03076	-2.89016	0.01470

Dependent Variable D/E

D - W statistics	Variable	Coeff	Std Error	T-Stat	Sig Level
1.896035	Constant	15.73982	2.39695	6.56661	0.00004
	UNITS	-0.80831	0.17068	-4.73591	0.00061

Dependent Variable DTA

D - W statistics	Variable	Coeff	Std Error	T-Stat	Sig Level
1.60773	Constant	1.35400	0.09025	15.00243	0.00000
	UNITS	-0.04150	0.00643	-6.45771	0.00005

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Table 4

The table shows performance of companies listed with Dhaka Stock Exchange (DSE) under Sector/SIC classification.
Returns are based from IFC emerging market data base.
Mean, Variance and Sharpe ratio are reported both in local currency and in US $.

	Sector/SIC Analysis		*09/09 Fishing*			
	Local Currency (Tk)			*US $*		
Security	*Mean*	*Variance*	*Sharpe ratio*	*Mean*	*Variance*	*Sharpe ratio*
Meghna Shrimps	-0.35586	1401.8845	-0.0095	-0.01918	0.7688788	-0.0219
* Beximco Fisheries	-0.13483	8084.255	-0.0015	-0.01762	4.4306746	-0.0084

* indicates companies belonging to Beximco Group.

	Sector/SIC Analysis		*322/22 Textile Mill Products*			
	Local Currency (Tk)			*US $*		
Security	*Mean*	*Variance*	*Sharpe ratio*	*Mean*	*Variance*	*Sharpe ratio*
Apex Spinning	-1.4272	3150.1712	-0.0254	-0.0541	1.7570	-0.0408
Apex Weaving	-2.1845	887.0365	-0.0733	-0.0602	0.4909	-0.0859
BD Dyeing & Finishing	0.8672	4546.9380	0.0129	0.0017	2.5064	0.0011
Monno Fabrics	-0.7385	675.1143	-0.0284	-0.0257	0.3705	-0.0422
Prime Textile	-6.8176	1671.6040	-0.1667	-0.1776	0.9357	-0.1836
Tamij-uddin Textile	-4.7241	963.6528	-0.1522	-0.1235	0.5278	-0.1700
*Beximco Denims	3.4614	4147.4213	0.0537	0.0596	2.3055	0.0393
*Beximco Knitting	1.1376	450.7524	0.0536	0.0113	0.2514	0.0226
* Padma Textile	-1.5724	########	-0.0088	-0.0717	17.6286	-0.0171
*Beximco Textile	0.3859	1119.1904	0.0115	-0.0042	0.6235	-0.0053
*Beximco Synthetics	0.4821	########	0.0045	-0.0068	6.2496	-0.0027

* indicates companies belonging to Beximco Group.

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Table 4 (continued)

The table shows performance of companies listed with Dhaka Stock Exchange (DSE) under Sector/SIC classification. Returns are based from IFC emerging market data base. Mean, Variance and Sharpe ratio are reported both in local currency and in US $.

Sector/SIC Analysis	*328/28 Chemicals & Allied Products*					
	Local Currency (Tk)			*US $*		
Security	*Mean*	*Variance*	*Sharpe ratio*	*Mean*	*Variance*	*Sharpe ratio*
Orion Infusion	-2.928	6024.8338	-0.0377	-0.07678	3.3068	-0.0422
Reckitt & Coleman	-2.327	5987.4966	-0.0301	-0.0695	3.3204	-0.0381
Square Pharma	-2.013	110076.16	-0.0061	-0.12623	61.0671	-0.0162
*Beximco Infusions	-0.528	18414.303	-0.0039	-0.04791	10.1168	-0.0151
*Beximco Pharma	-0.708	3489.3634	-0.012	-0.02363	1.917	-0.0171

* indicates companies belonging to Beximco Group.

Sector/SIC Analysis	*550 / 50 Wholesale Trade-Durable Goods*					
	Local Currency (Tk)			*US $*		
Security	*Mean*	*Variance*	*Sharpe ratio*	*Mean*	*Variance*	*Sharpe ratio*
* Beximco	0.46483	########	0.00470	0.00385	5.35834	0.00170

* indicates companies belonging to Beximco Group.

Sector/SIC Analysis	*667/67 Holding & Other Investment Services*					
	Local Currency (Tk)			*US $*		
Security	*Mean*	*Variance*	*Sharpe ratio*	*Mean*	*Variance*	*Sharpe ratio*
*Shine Pukur Holdings	0.1007	########	0.0008	-0.0059	8.4476	-0.0020

* indicates companies belonging to Beximco Group.

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Table 5

Portfolio Performance of Index Listed with DSE

This table shows the index perforemence of Dhaka Local index, IFCG Dhaka Index and a homemade Beximco Group portfolio index from 10 companies of the group listed with Dhaka Stock Exchange (DSE).
Returns are based from IFC emerging market data base. Mean, Variance and Sharpe ratio are reported both in local currency and in US $.
Sharpe ratio is Mean to St deviation.

Index	*Local Currency (Tk)*			
	Variance	*St Dev*	*Mean*	*Sharpe ratio*
Dhaka Local Index	########## #######	########## ####	-7.2000	-0.0218
IFC Dhaka Index	2387.9825	48.8670	-0.0700	-0.0014
Beximco Group Index	5845.0810	76.4531	0.3089	0.0040

Index	*US $*			
	Variance	*St Dev*	*Mean*	*Sharpe ratio*
Dhaka Local Index	60.1900	7.7582	-0.243	-0.03089
IFC Dhaka Index	2142.3427	46.2854	-0.629	-0.01359
Beximco Group Index	3.2293	1.7970		-0.00573

Obs Period 1996/01-1998/05

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Table 6

Dhaka Stock Exchange Profile

(Currency in millions)

Table 6 shows market profile for Dhaka Stock Exchange (DSE) from October '97 to April '98. Informations are from IFC emerging market data base.

	Oct '97	*Nov'97*	*Dec '97*	*Jan '98*	*Feb '98*	*Mar'98*	*Apr '98*
A.Number of Listed companies							
Dhaka Stock Exchange	198	199	202	202	203	203	203
B. Market Capitalization							
In Taka	73,645	68,191	69,166	67,864	63,051	58,421	52,103
In US $	1,653	1,531	1,537	1,486	1,357	1,258	1,122
C. Trading Value							
In Taka	1,660	1,327	1,086	926	810	843	481
In US $	37	29	24	20	17	18	10
Turnover ratio	2.2	1.9	1.6	2.1	1.2	1.4	0.9
D.Local Index							
Local Market Index	839.6	749.9	756.8	741.8	687.5	644.8	574.4
Change in Index (%)	-10.7	-10.7	0.9	-2	-7.3	-6.2	-10.9
E. IFC Global Index							
Number of stocks	46	46	46	46	46	46	46
Share of market cap (%)	64.5	65.5	64.7	65.6	65.8	66.5	67.1
Share of trading value (%)	87	65.5	63.7	63.4	63	66.3	70.5
P/E ratio	16.2	14.6	13.5	13.7	12.8	12	10.6
P/BV ratio	2.4	2.2	2.1	2.1	2	1.9	1.7
Dividend Yield	3.3	4.3	4.3	4.3	4.6	4.9	4.9
Total return index (Dec=100).	107.6	101.9	101.4	99.5	91.2	85.2	77.3
Change in total return index(%).	-12.7	-5.3	-0.5	-1.8	-8.3	-6.3	-9.6
F. ExchangeRates							
Exchange rates (end of period)	44.541	44.541	44.991	45.66	46.45	46.45	46.45

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Figure 1

The figure shows Beximco Group Sales & Total expense yearwise from 1983-1995.

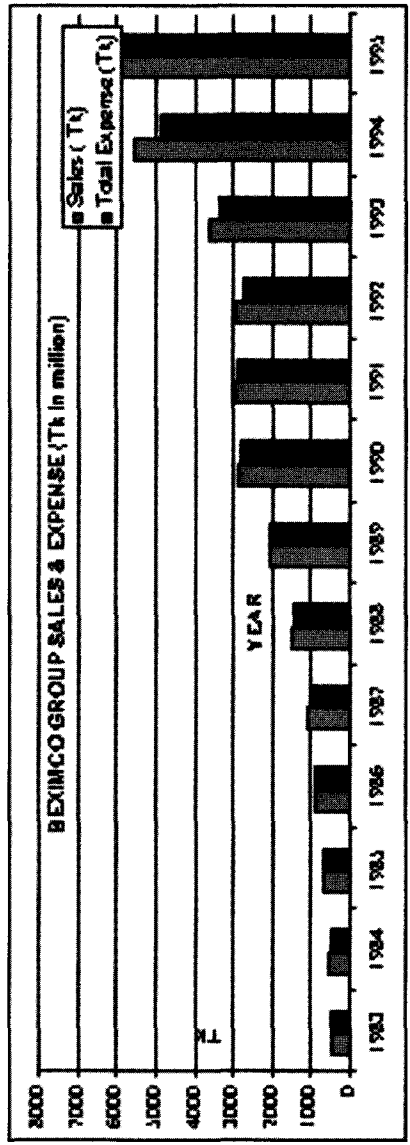

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Figure 2

The figure shows Beximco Group Sales & Total expense yearwise from 1983-1995.

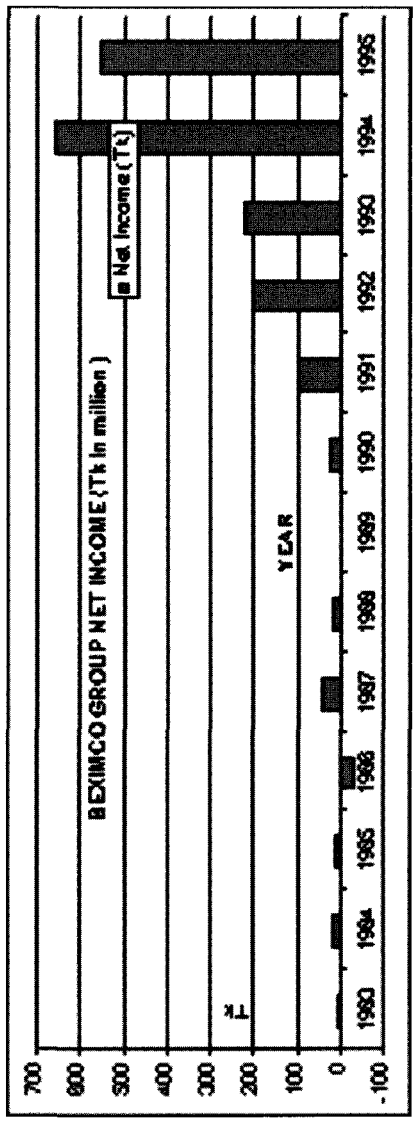

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Figure 3

The figure shows Beximco Group Sales & Total expense yearwise from 1983-1995.

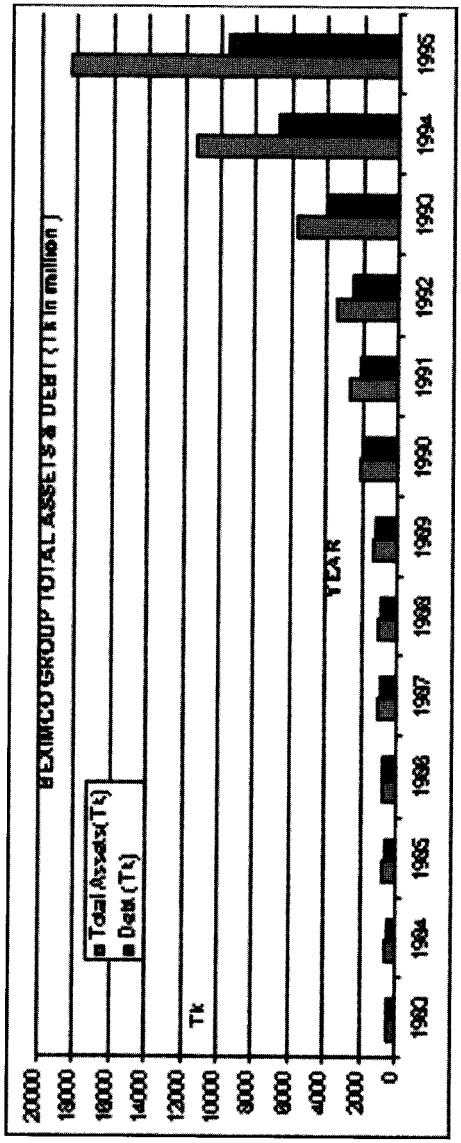

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Figure 4

The figure shows Beximco Group Sales & Total expense yearwise from 1983-1995.

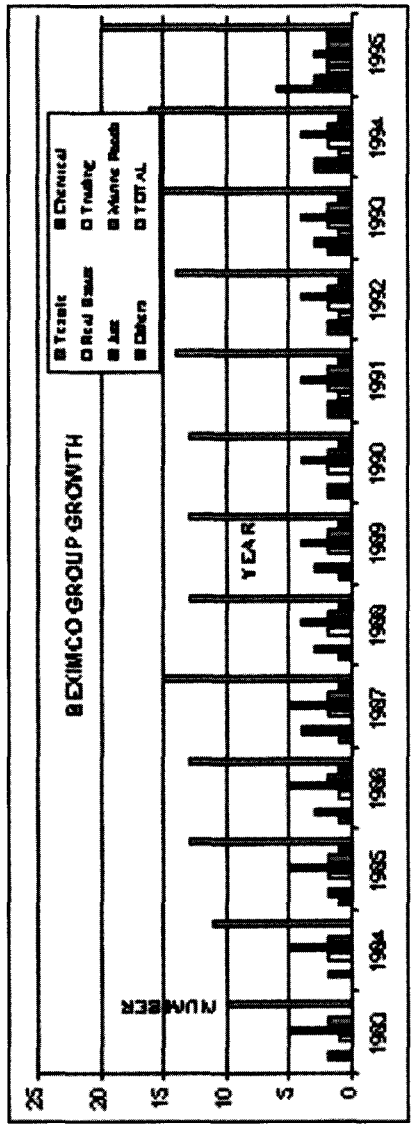

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Figure 5

The figure shows Beximco Group Sales & Total expense yearwise from 1983-1995.

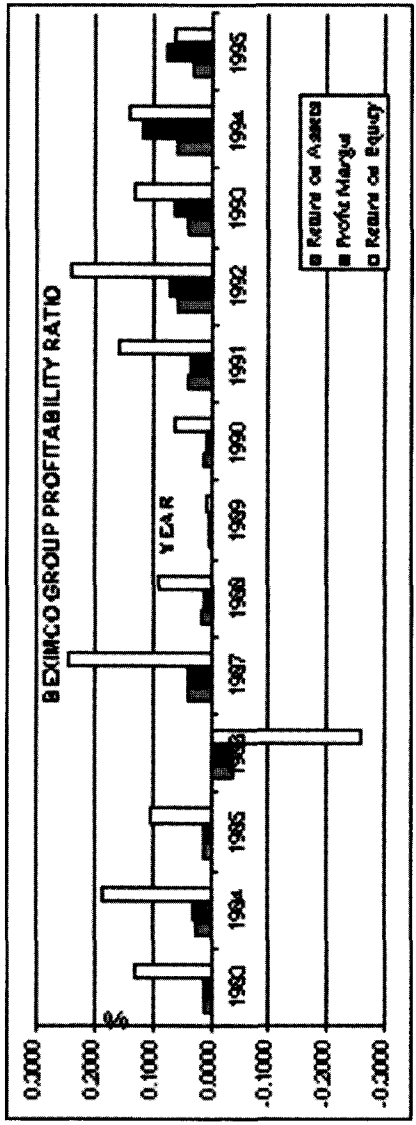

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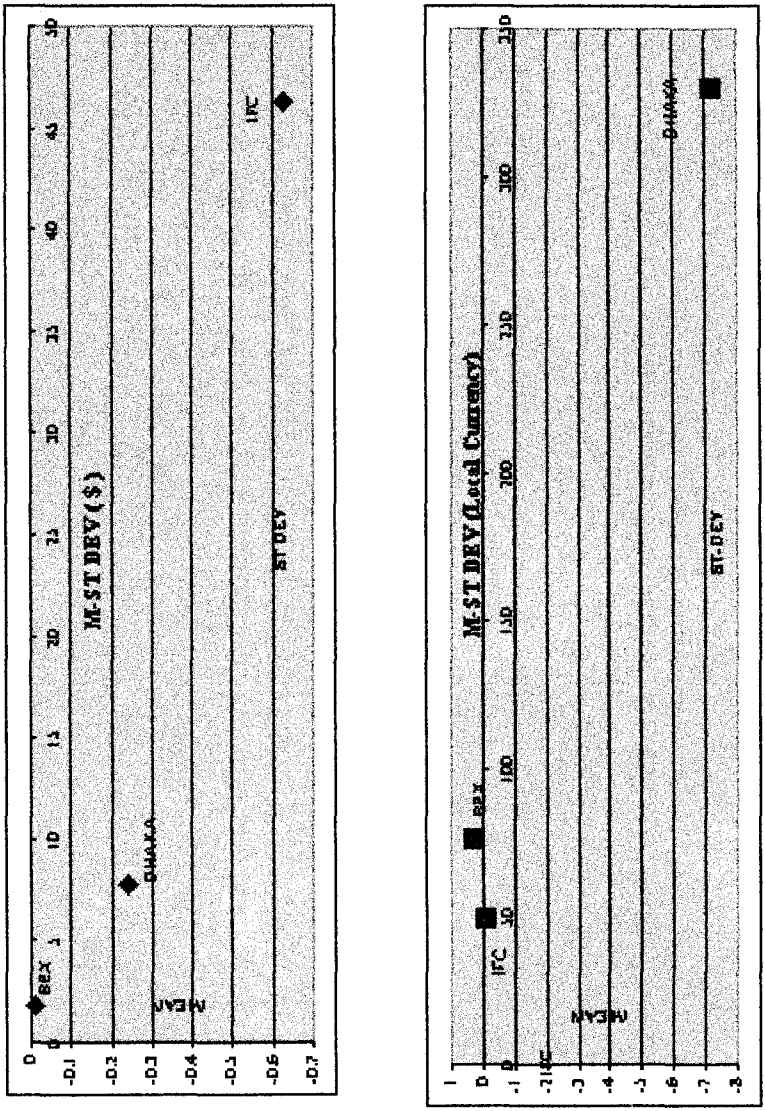
Figure 6

The figure shows the performance of the Indexes in M-ST DEV frame work both in local currency and in $.



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The group structure is sometimes vague and implicit in many countries. This may be an intended result, in order to get benefit from various financial and business transactions among member firms. The methods of forming a group differ depending on the institutional features of a country. The most common method is to use the group' s holding company or group's financial institutions (Mexico, Philippines, Indonesia, India) In countries where the financial holding company is restricted and the financial institutions' equity holding is regulated, mutual shareholding, pyramidal ownership and interlocking directorship are used (Korea, Taiwan, Japan). Direct share ownership by the founding family is also used in many countries.

3.2 Beximco Group

Beximco Group, during its thirty-five years of existence, has grown to become the leading business organization in Bangladesh. In March 1965, a small but ambitious company refused to toe the industry line (jute), and decided to pave its own path. The company that started with a jute-spinning mill might have ended there, but for several reasons Beximco today is one of the largest conglomerates of Bangladesh. The refusal to toe-the-line and follow the rest of the jute industry caused Beximco to venture out into products that no one in Bangladesh had thought of getting into at that point of time.

In the 1960's and 1970's jute and related jute products was the backbone of the economy of the then East Pakistan, now Bangladesh. The jute industry accounted for more than 80% of export earning of the country. In the early 1970's, at the time of large-scale nationalization, everybody was taking the easy way out. Beximco took a different and challenging path, the path that led Beximco to establish itself as a leading institution. With more than 15,000 people in employment and well-diversified activities ranging from shrimp cultivation to gamma irradiation of food and medical products, and from construction to fine chemical production, Beximco group as of today, with its 25 companies is the largest private sector business conglomerate. Its pioneering role in developing the country's export and barter trade has been widely recognized both at home and abroad. The group holds about 15% market capitalization in the local stock market and contributes 1/6 of the country's total exports.

3.3 Investment Opportunities in Bangladesh

In order to answer the question "Does diversification pay off?" we analyze Beximco Group, which operates in an environment that is completely different from that of the developed world. To understand diversification in such a setting we have to look at the present business

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climate that prevails both in the industrial and economic sector of Bangladesh. When Bangladesh was a part of Pakistan, known as East Pakistan, most of the heavy enterprises were state owned. Only a few private sector enterprises existed, but entrepreneurs coming mostly from West Pakistan too owned that. In 1971, after a political deadlock that led to the War of Liberation, East Pakistan liberated itself from Pakistan to become an independent state, Bangladesh. The newly born state had a war ravaged economy and the geo-political factors that helped towards the liberation of the country influenced the political leaders at point of time to nationalize all private sector enterprises, including those that belonged to local entrepreneurs. The local stock exchange known as the Dhaka Stock Exchange was closed down. Nationalization was the order of the day. State owned enterprises (SOEs) ranged from producing papers, fertilizer, sugar, steel, machine tools, dock and shipyard, airline, jute, cotton and textile, engineering, chemical, leather, banking and many others. This trend, however, was reversed in 1975 when the Government started a privatization policy. Local entrepreneurs were allowed to set up industries and businesses to compete with state enterprises. The Government slowly started to loosen its grip on all publicly controlled activities and initiated industrial reforms. This includes liberalized industrial policy, export-oriented private sector-led growth strategy, no limitation pertaining to equity participation, no permission of the Government required to set up new industries. In addition, the Government has set up a body known as Board of Investment (BOI) whose sole task is to facilitate entrepreneurs to get institutional facilities like procurement of land, electricity, gas and other utility connections at a fast pace. BOI further helps in identifying the roadblocks on the way of implementation of projects and measures to remove them.

The Government also provides incentives to accelerate industrialization at a faster pace. This includes a tax holiday from 5 to 10 years depending on location of the industries (developed or non-developed areas). The policy also has provisions that facilitates for the repatriation of invested capital, profit and dividend, exemption of tax on interest on foreign loan, tax exemption on royalties, technical know-how and technical assistance fees, working capital loan, as well as term loan, from local commercial banks to the industries set up with foreign capital. In Bangladesh, business can be carried on by a locally incorporated and a foreign company incorporated outside but registered in Bangladesh.

The Dhaka Stock Exchange (DSE) is a tiny stock market operating since 1973. The orders flow system and trading mechanism of the

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exchange naturally retard volatility but at the same time restricts access to the market. The trading mechanism is essentially a double-auction call market sequentially held in each stock. The method used has several limitations that restrict the number of issues traded, trading volume capacity of the exchange, its liquidity and informational efficiency. The DSE is in the process of implementing online nationwide trading via VSAT channel, online worldwide trading over the Internet, and automation of services, increased membership from present 195 to 500 and having a Central Depository System.

4. Difference in the Institutional Structures between Bangladesh and the Western World

Bangladesh has only been an independent country for 30 years. Bangladesh falls in the category of a frontier market and by International Finance Corporations (IFC) criteria, still one step behind to qualify for the emerging status. In most of the emerging markets, there are different kinds of markets failures caused by informational and agency problems; Bangladesh is no exception. In fact, imperfection is visible in every domain of the economy. There is an absence of intermediaries in the financial markets, product markets and labor markets. Therefore, the absence of intermediary institutions in Bangladesh makes it costly for firms to acquire necessary inputs like finance, technology and management talent. Market imperfections also make it expensive to establish quality brand images in product, and to establish contractual relationship with joint venture partners. The available institutional infrastructure and the existing investment opportunities in the country, drive a company or group to develop its strategy. As a result, an enterprise can often be more profitable pursued as part of a large diversified group, which can act as an intermediary between individual entrepreneurs and imperfect markets.

The capital market in the Western world, like the US and UK are matured and highly developed, equity-focused, monitoring by disclosure rules and the market for corporate control. However, in the case of Bangladesh, capital market can be said to be in its infancy, characterized by underdeveloped, illiquid equity markets and nationalized banks, weak monitoring systems, often by the bureaucrats. Stock markets are still going through a process of trial and tribulations. Labor markets in the West have many business schools and consulting firms that offer talent and certified skills to enhance mobility, whereas in Bangladesh there are few business schools with very little management training and talent. Product markets in the West are efficient with reliable enforcement of liability laws and with many consumer activists.

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Government regulation is low and relatively free from corruption and enforcement of contracts is predictable. Bangladesh has hardly any consumer protection and despite high governmental involvement and regulations, corruption run high and enforcement of contract is very low. Thus, product, labor and capital markets are characterized by institutional voids in Bangladesh, consequently, firms and groups operate and conduct business in such an environment.

There exists a gulf of difference between the West and a developing country like Bangladesh. Under these circumstances, diversification in the West may not be a good strategy, but in Bangladesh diversification has many advantages. Diversification begins in an often-unrelated fashion. Informal relationships, mostly through common family ownership between group firms exist at all stages of a group's development. Diversified groups also install formal systems of coordination among group companies.

Diversification in Bangladesh practically is done via the floating of new companies. In order to be successful, companies have to undertake a wide range of functions to perform business effectively. Enterprises can often be more profitably pursued as a part of a large diversified business group, which can act as an intermediary between individual entrepreneurs and imperfect markets. The diversified groups are able to bring resources to new business by pooling resources from the existing group affiliates to initiate new ventures, and also use their reputation to attract the necessary complementary assets such as managerial talent, technological know-how, domestic and international capitals. Political connections play a prominent role in acquiring domestic and foreign capital. Large diversified groups in Bangladesh are able to pull strings in order to achieve their objectives. It is this difference in the institutional structures that explain why a diversification strategy may lead to growth and for this reason focused operations may be a wrong strategy to follow in a country like Bangladesh. Focus may be good in a developed market like the US or UK, but not in a developing market like Bangladesh. A focused strategy will not lead to growth. Companies in Bangladesh must adapt to strategies that fit their institutional context: product, capital, labor markets and regulatory systems and mechanisms for enforcing contracts

Beximco Group has survived the initial scares during its infancy stage in the early 1970's and has successfully passed its 35 years of operation in Bangladesh. Therefore, under the present environment when the government is following a liberalization policy coupled with investment opportunities and incentives given out to attract investors both from home and abroad, we can state our hypothesis for Beximco

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Group that diversification will lead to growth and create value. In response to the question "When do shareholders benefit from a firm's diversification"? Coase (1937) has said that the boundary of the firm should be at the point at which "the cost of organizing an extra transaction within the firm becomes equal to the cost of carrying out the same transaction by means of an exchange in the open market or the cost of organizing in another firm". Williamson (1981) and others point out that this answer requires an operational definition of transaction cost. Depending on one's view of transaction cost, one can find if a firm is either efficient in organizing or not. The definition of Coase, Williamson and others can be applied to determine if Beximco Group is organized efficiently and producing the desired results.

Beximco Group is a classic case of founding family controlled firms and enjoys a tremendous intangible asset base in Bangladesh. The family involvement creates a system of social norms that reduces intra-group transaction costs by encouraging information dissemination among group firms, reducing the possibility of contractual disputes and providing a low-cost mechanism for dispute resolution. Bangladesh has not yet reached the stage of development that is at par or comparable to a developed country. Specialization or single unit firms cannot be expected to grow at a very fast pace. We argue the contentious issue whether diversification pays off or not from the analysis of the Beximco Group operations in a thin, inefficient market like Bangladesh. Appendix 2 shows the institutional differences of Bangladesh corporate world with those in the U.S., the U.K, India and Bangladesh.

5. Data and Methodology

We have collected the Audited Annual Reports of the Beximco Group from 1983 to 1995, and have used comparative financial statements that permit interpretation of important accounts and account groups. This helps the decision-maker to identify the causes of changes in a firm's position and have a better perspective of the future trend/position. We have also used accounting ratios to establish a relationship of value creation and growth of the Group through increased performance over the years. Ratios, like other financial analysis data, normally provide meaningful information only when compared to a previous ratio for the same firm or similar firms. Some analysis techniques compare a firm's performance in one time period with its performance in different time periods, and in this case, since it is just one firm, we have compared ratios from 1983-1995. Although accounting ratios are generally not equivalent to the economic ratio of return due to different methods of computing depreciation and the

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timing of cash flows and capital expenditure (Fisher and McGowan, 1983), previous researches have concluded that accounting ratios (Kay, 1976, Kay and Mayer, 1986) are highly correlated with economic ratios. Thus, from the studies cited, it is appropriate to use accounting ratios to measure a firm's performance. We have calculated the following accounting ratios to measure the performance of Beximco Holding companies:

Operating ratio
- Asset turnover = NS/TA.

Profitability ratio
- Profit margin on sales = NI/NS
- Return on Asset = NI/TA.
- Return on Equity = NI/Equity

Debt-Management ratio
- Debt to Equity = Debt/Equity
- Debt to Asset = Debt/TA

We also ran a regression with UNITS as the independent variable and financial ratios as the dependent variable. $RATIO = a_0 + b_1 UNITS + e_t$.

IFC's Emerging Market Data Base (EMDB) has monthly returns available for the Dhaka Stock market from December 1995 to May 1998, and Beximco Group has ten of their companies listed with the Dhaka Stock Exchange (DSE). We have compared the performance of the Group listed companies with the other companies listed with DSE classified by sector/SIC code. Also, we have formed an equally weighted portfolio comprising of the ten companies of the Beximco Group listed with DSE and compared that with the Dhaka Index (local market index) and the IFC Dhaka Index. We have calculated the mean, standard deviation and Sharpe ratio for these indexes. This helps us to make an observation on the performance of the group with other firms in the same market.

6. Empirical Results

Table 1, Panel A shows the comparative financial statement of Beximco Group's performance during the years 1983-1995. During this period (13 years) there is a growth in sales of 1463.79 %, from Tk. 460.9 million in 1983 to Tk. 7207.51 million in 1995. For the same period Net Income rise from Tk. 5.05 million to Tk. 551.87 million, an increase of 10828.12 %. Total Assets growth records a rise of 4303.67 % from Tk. 417 million to Tk. 18385.3 million. Debt growth registers a rise of

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2431.69 % from Tk. 379.29 million to Tk. 9602.44 million, while Equity recorded a remarkable increase from Tk. 38.21 million to Tk. 8782.86 million, a rise of 22885.76 % for the period 1983-1995. Total Expense rose from Tk. 455.85 million to Tk. 6655.64 million during the course of 13 years (an increase of 1360.05%). Despite the rise in total expense, sales growth is much higher. Net income is positive all along the period of study except for 1986 when it records a net negative income. This may be due to the political strife that was occurring in the country against the Government during that period. Political agitation is a common phenomenon in this part of the Indian subcontinent. All of the above findings indicate that Beximco Group did have a phenomenal growth in the areas noted in the comparative financial statement. Although debt has risen manifold, the equity provided by the owners shows a greater prominence to debt.

Table 1, Panel B shows the yearly percentage changes. The mean in the six areas (Sales, TA, NI, Debt, Equity and TE) demonstrates a remarkable growth except for 1986, when the Group suffers a net negative income. The net incomes for 1988 and 1989 do not reflect a superior performance, but show net positive income. Despite the bumps along the road, the Group on the average records a sales growth, which exceeds the growth in expenses. The Group over the period 1983-1995 expands its operations from 10 units to 20 units (companies), a growth of 100%. Table 2 shows the breakdown of each units (company) annual growth. During 1986-1988, the group has had to undergo various reorganizations of its operations by closing down two units to control the declining profits. This is perfectly in line with business norms. Management efforts in diversification to new areas of business show prudent policymaking decision in carrying out business in an environment when Government is pursuing a liberalized industrial policy to accelerate economic development of the country.

Table 3, Panel A shows the accounting ratios for the Group from 1983-1995. The operating ratio (Asset turnover) has fallen from 1.104 times to 0.392 times during this period. One of the possible reasons for low asset turnover can be explained by the fact that when a new operation (company) is floated, trial production takes place and products are marketed in order to gain market share. Gradually the production is increased when market share increases, leading to a rise in sales; this will gradually lead to a better asset turnover. For Beximco Group, the present low asset turnover should not be viewed as an inefficient utilization of assets. An increase in the future sales will take place and the Group will make improvement in efficiency. The Group is still in the growing stage. For the same reason, the profitability ratio on

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return in asset will grow in the future. Return on Equity on average is 10%. Profit margins during this period have been positive, except for 1986, when the Group suffers an overall loss, may be due to reasons as discussed earlier.

The Debt-Management ratio also shows promising trends. Debt/Equity has come down from 9.926 to 1.093, while Debt/TA has fallen from 0.908 to 0.522. This indicates that the equity provided by the owners have increased as Total Assets (TA) financed by debt is about 52.2% in 1995 compared to 90.8% in 1983. These are all very encouraging trends as greater equity means owners have more stakes involved with the group and it augurs well for the future. Table 3, Panel B reports the univariate regression results. We run six regressions with financial ratios as the dependent variable and UNITS as the independent variable. The six dependent variables are ROA, ROE, PM, ATO, DE and DTA. We find the coefficient value associated with UNITS to be significant for all the regressions. With ROA, ROE and PM, we find the coefficient to be significant and positive, i.e. increase in Units (diversification) increases ROA, ROE and PM, while with ATO, DE and DTA to be significant and negative, i.e. increase in Units decreases ATO, DE and DTA. The regression results do confirm that equity provided by the owners increase with diversification and this in turn reduces the debt. Similar is the conclusion on Debt to Total Asset and Assets turnover regression results.

Table 4 shows the market performance for the Group's 10 units (companies) listed with the DSE and when compared with similar companies listed with DSE classified by Sector/SIC code, Beximco Group shows better results than the others. Table 5 shows the Beximco Group portfolio performance to the Dhaka Local Index and the IFCs Dhaka Index. Beximco Index performance is by far the best when compared to the other two. The Sharpe ratio (Mean to St deviation) is better for Beximco's portfolio than both the Dhaka Local Index and the IFC Dhaka Index. Table 6 shows the market profile of the Dhaka Stock Exchange.

7. Conclusion and Comments

Judging by the criteria used (Comparative financial statements, Accounting ratios, and Stock market returns) Beximco Group has made significant progress towards the path of growth through value creation. The findings support the hypothesis that growth through diversification occurs for the Group in Bangladesh. The future is promising for the Group's operation in the country. Since it is a typical founding family controlled conglomerate, it is expected that it will grow further down the

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road and help in the economic development of Bangladesh as well as provide thousands of jobs for both skilled and unskilled labor forces readily available in the country. Therefore, one may conclude Beximco Group's performance is satisfactory in context of the prevailing institutional infrastructures and the setting of a developing country.

What Khanna and Palepu (1997) observe in their study is fully applicable for Beximco, which operates in an environment that is completely different that from the West. Baker (1992) finds for the Beatrice Group in US, in his chronological study, that for the most part of its existence from 1891 till late 1970s diversification plays an important role for its growth from a small creamery firm to be one of the largest conglomerates in US. This is similar to what we see today for Beximco's growth in Bangladesh. Diversification is the leading factor for the rise in prominence for Beximco during its 30 years of existence. Fama and Jensen's (1983) family relationship and De Angelo and De Angelo's (1985) findings on monitoring and managerial discipline are very much applicable for the Beximco Group. The Group's performance is a success story and other business firms in Bangladesh can draw inspiration and encouragement, and compete with Beximco Group.

We find from the literature on the role of diversification leading to value creation or destruction to be inconclusive for the Western world. At one point of time diversification has played a pioneering role in the rise of conglomerates in US and then the break up of the same conglomerates lead to value creation. Our findings on Beximco support the role of diversification. It supports the notion that a large diversified business group can add value in an emerging or frontier context by replicating the functions of institutions that are missing in the economy of Bangladesh. The findings reinforce and contribute to the literature that institutional infrastructure and settings in a country define the role of diversification. Greif (1994) observes, in his study of institutional structure of economies that "it is misleading to expect that a beneficial organization of one society will yield the same results in another".

The main contribution of this study is that it looks at the gains obtained via diversification in a setting other than US, in a developing country like Bangladesh, where the terminology like M&A, corporate raids, sell off, spin-offs, buyback and stock market reaction are still non-existent. Devoid of all the institutional facilities and features that the West offers to the corporate world, diversification is the answer for growth and value creation. Although our study is based only on one group and has data constraints, we believe that this is a part of the institutional void in an imperfect market like Bangladesh. Due to the absence of reliable time series data, it is difficult to say we have

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addressed all issues relating to growth, but our study is an effort in that direction to see what institutional differences play in a setting other than US. Substantial differences in group structure and performance exist relative to diversified firms in developed economies, and also among groups in different emerging markets. For future research, we expect to address the issue of diversification in the institutional context of Bangladesh by adding more business firms when data storing and gathering processes improve.

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Appendix 1: Leading business groups (Million US $, %)

Country	Business groups	Groups sales	Groups assets	No. of Affiliated companies	No. of employees	Sales divided by GNP (%)
Korea	Samsung	35399	32261	24	172950	14.3
Indonesia	Salim	7220	N.A.	427	135000	7.2
Taiwan	Formosa	6216	6887	17	47000	4.1
Hong Kong	Li Ka-Shing	3476	11907	122	N.A.	5.3
Thailand	Siam	1613	1154	70	13259	2.5
Philippines	Ayala	713	2833	43	N.A.	1.7
U.S.A.	General Motors	125126	N.A.	N.A.	761400	2.2 -

Source: Sato(1993), World Data 1995, Financial Statistics (Taiwan District, ROC)

Notes: Most figures are for 1989 and 1990.

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Appendix 2: The Institutional Context

The table shows the difference in the institutional context in the developed markets, emerging market and a frontier market. The first four columns are from Turun Khanna and Krishna Palepu. (1998)

Institutional feature	United States	Japan	India	Bangladesh
Market for finance	Equity focused, disclosure rules and the market for corporate control monitor managers.	Bank focused, monitoring by interlocking investments and directors.	Under-developed, illiquid equity markets and nationalized banks, weak monitoring by bureaucrats.	Under-developed, highly illiquid equity markets and nationalized banks, very weak monitoring by bureaucrats.
Market for labor	Business schools and consulting firms offer talents; certified skills and welfare benefits enhance mobility.	Few business schools; training takes place smoothly within firms, firm-specific development of talent.	Few business school; but little training, management talent is scare, workers inflexible.	Only one recognized business school. Few private business schools set up recently; management training and talent are scare workers inflexible and highly unionized.
Market for products	Reliable enforcement of liability laws and efficient information dissemination, activist consumers.	Reliable enforcement of liability laws and efficient information dissemination, less activist consumers.	Limited enforcement of liability laws, little information dissemination, and no activist consumers.	Practically no enforcement of liability laws, little information dissemination, and no activist consumers at all.
Governmental regulation	Low, relatively corruption-free.	Moderate, relatively corruption-free.	High, corruption is common.	Very high, corruption is rampant.
Enforcement mechanisms	Predictable.	Predictable.	Unpredictable.	Unpredictable.

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Institutional feature	United States	Japan	India	Bangladesh
Corporate scope	Focused: diversified groups have disadvantage.	Groups have some advantages.	Groups have many advantages.	Groups have many advantages.

Source: Turun Khanna and Krishna Palepu. 1998. Corporate Scope and Institutional Context: An Empirical Analysis of Diversified Indian Business Groups. Harvard University Working Paper. Page 37.

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Book Reviews

The Ownership Solution: Toward a Shared Capitalism for the 21st Century
Jeff Gates
Addison-Wesley, 1998

Jeff Gates, who has long been involved in the movement for ESOPs (employee stock option plans) in the United States, argues in this book for worldwide systemic changes in the financial structure of capitalism to create a broadly distributed ownership of productive enterprise. He argues that there is a "design flaw" in capitalism as we now know it. By virtue of this flaw, the financial system produces more capital for those who already have it, but does little to "create more capitalists." As the book's subtitle suggests, Gates favors a "shared capitalism."

It is hard to know how to categorize Gates, and perhaps under impending world economic conditions it is unnecessary to do so. In the past, it would have been valid to point out that his enthusiasm for worker ownership reflected either (a) a dishonest, because unadmitted, desire to promote a transition to socialism as many socialists have advocated it for well over a century; (b) a naive, because uninformed about that history, effort to do the same thing; or (c) a desire to inject some modicum of worker ownership into a market economy, but without an exclusionary animus against the wage system, which would not itself be inconsistent with a free market system.

Worker ownership, when combined with an opposition to other forms of enterprise that involve "the wage relation," has long been part of the socialist program. Indeed, Louis Kelso and Mortimer Adler's book The Capitalist Manifesto (1958) was a plea for socialism, quite transparent to anyone who read the book seriously (which few did). The fact that so many advocates of a free market have gotten onto the ESOP bandwagon is explainable by their not understanding this, combined with their implicit assumption that employee ownership would never be carried to the point of banning other forms of enterprise.

The idea that capitalism has a "design flaw" making the rich richer and the poor poorer, and leading also to overproduction and a lack of purchasing power in the hands of the masses, has also been around for well over a century. It has been central to much socialist thought. If nothing new has been added to the equation, this is a tired, much

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refuted, argument – overcome by the immense productivity and broadly raised living standards generated within market economies.

The question that those who support capitalism and to whom socialism is anathema must now ask themselves, however, is whether this perception of a flaw as just described is now being borne out by the rapid on-rush of a radically labor-reducing technology. In the impending age of computers, robots, materials science and biotechnology (an age that is just beginning, even though we may think we are fairly well into it), will it not in fact be true that immense rewards will come to those who own the technology, while the billions of people who are not owners of the capital and who inevitably will not be "knowledge workers" compete for a constantly diminishing economic role? If this occurs, it will show up as mass unemployment in many areas of the world – or as a vastly increased polarity of incomes and wealth in societies where wage flexibility is allowed to foster a continued near-full employment.

It does seem to this reviewer that the technological revolution, which far surpasses anything we have experienced before even during the Industrial Revolution, raises questions that all proponents of a free market must, sooner or later, take seriously. These questions will be painful, precisely because they point toward the need to reexamine long-exploded socialist nostrums. Once that reexamination starts, there will be much reason for dialogue between market-economy enthusiasts and such thinkers as Jeff Gates. The necessity will be to maintain a vigorously competitive global market, with all the innovation inherent in it, while establishing the economic basis for a civilization in which all benefit. The second part of this will be valuable for its own sake, but is also imperative if social order is to be maintained. In a world of revolution and violent desperation, nobody will thrive.

One difficulty with Gates' suggestions is that they center heavily on workers sharing in ownership. This presupposes widespread employment. If the promise for the future is going to be non-labor-intensivity, the sharing of ownership will hardly be able to be accomplished by bringing in employees. Nor does Gates concern himself particularly about the lack of diversification that employee ownership of individual enterprises entails. (This is no small problem, since firms have a very real propensity to fail, especially under the competitive conditions that have come to exist in the world market.) He mentions GSOCs (general stock ownership corporations), in which large numbers of people own shares of broadly-based productive processes such as the Alaska oil field; and it seems that this offers much more promise for the future than employee ownership. It may be that he sees

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employee ownership as merely a stepping-stone to this, but if so he doesn't see his way clear to say so.

The Ownership Solution is far more relevant today than the Kelso-Adler book was in 1958. People of all persuasions are well-advised to begin reading this literature seriously.

Dwight D. Murphey

How I Accidentally Joined the Vast Right-Wing Conspiracy (and Found Inner Peace)
Harry Stein
Delacorte Press, 2000

Harry Stein has written prolifically along popular lines as an ethics columnist for the *Wall Street Journal*, the author of both fiction and non-fiction books, and a frequent contributor to such media as *GQ*, *Playboy*, *New York*, *Esquire* and *TV Guide*.

The result is that he brings a sprightly and entertaining style (such as is evidenced in the title) to this book that tells of his conversion from the radical Left in the United States to a moderate form of cultural conservatism. The book is not a profound tome such as Whittaker Chambers' *Witness*, but it does make a delightful read as it pierces one after another of the shibboleths that prevail in intellectual circles today.

Stein tells how he moved away from an unquestioning acceptance of the Left's mindscape, an acceptance that began with him as the child of Communist parents. It was mainly his own becoming a parent that caused him to question first one thing and then another about the prevailing relativism, cynicism, multiculturalism and feminism. "Trust me, once you start, the process of seriously rethinking things takes on a life of its own; second thoughts (say, about declining school standards) lead to third ones (the new emphasis on self-esteem over knowledge) and then to fourth (the particulars of the multicultural curriculum)."

Over time, he became acutely aware of hypocrisies and double-standards within the left-liberal position. What hit him most directly and personally, of course, was the gulf between "progressive" opinion's "vaunted reverence for free expression," on the one hand, and its "ready contempt directed at actual diversity of thought," on the other. He remembers distinctly the first time his new-found conservatism caused an erstwhile colleague to call him, sneeringly, "a fascist."

Thus far, his odyssey has taken him primarily into cultural conservatism. He came to see the value and importance of "personal responsibility," of the need to make serious demands on oneself; of a

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sense of shame, and of gaining self-respect by earning it. Whereas at one time "indulging ourselves" took a high priority with him in keeping with the counter-cultural attitudes of his peers, he developed an appreciation for monogamous marriage: "Once in a while, it can seem like a rotten bargain. But in the end lots of us stick to it for basically selfish reasons: because it works. Because we love our spouses and don't want to cause them pain. Because the well-being of our kids is immeasurably more meaningful than indulging ourselves. Because somewhere along the line we've learned that having values and sticking to them is the formula for an infinitely more fulfilling life."

This has affected his political outlook. One of the more important features of the Clinton scandals was how reflexively the great majority of Democrats and liberals rationalized a partisan defense. Stein, however, sees Clinton as "a man whose ambition was unchecked by any of the nobler impulses" and present-day Democrats as, for the most part, practitioners of "racial and gender extortionism."

He sees multiculturalist ideology as distorting important aspects of American history, and feminism as having revealed itself "as more partisan than principled." He praises Wendy Shalit's recent book *A Return to Modesty: Discovering a Lost Virtue*.

This is not to say that Stein's migration from Left to Right is complete. It seems impossible to say where his thinking will be in ten years. There are many facets of "progressive" thinking he has yet to question, although the "one thing leads to another" process may lead him to do so. Probably most apparent is his lack of scholarly bent. The time-frame of his thinking seems entirely encompassed by his own life and experience, so that he has no historical perspective to help him in understanding the terrain he has been crossing. Nor does his book show any sign of his having dipped into the serious writing that exists within the various branches of conservative thought to see in what way they may inform him. One of the prejudices of the Left, of course, is that there is no conservative intellectual tradition to speak of; and either by an implicit acceptance of that premise or by a personal inclination away from reflective study, he has, so far at least, left himself on the periphery of conservative intellectuality.

Stein is among the most recent of a long line of intellectuals who since the 1920s have been "mugged by reality" and have accordingly fled the Left in search of something better. Fortunately for him, his conversion did not come from "hearing the screams," but from a streak of common sense and independence that somehow enabled him to break free. For greater depth, there would be no better place for him to start than by reading the later works of such individuals as Max

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Eastman, James Burnham, Freda Utley, Sidney Hook, Peter Collier and David Horowitz (to mention just a few).

Dwight D. Murphey

Holy War, Inc.: Inside the Secret World of Osama bin Laden
Peter L. Bergen
The Free Press, 2001

One of the paradoxes of war is that two diametrically opposite perceptions of the opponent need to be held simultaneously. On the one hand, there is both the natural urge and the practical imperative to demonize and dehumanize the opponent. In the case of Osama bin Laden and the radical Islamists he leads, the carnage of September 11 has enraged the American people, who have been reminded in the most graphic way that retribution is essential to justice and who yearn to return to the life without fear that has been one of the implicit values of their society. This merges easily into a satisfaction of the need for anger as a spur to action. Subtlety is not a hallmark of the emotion that leads masses of people to bear gladly or even stoically the sacrifices and dangers of war.

On the other hand, there is a need to understand the enemy and the causes of the conflict, looking ahead to the transcendence that ultimately will have to be reached if the world is to return to normal. Rational understanding is the opposite of caricature. Declamations about the pure evil of the opponent give way, here, to facts and analysis – and hopefully to some comprehension of what moves the opponent as a human being.

In this book, Peter Bergen has sought to achieve a balance between these opposites. It isn't likely that anything he says will strike a false chord with the rage and fear and need for action. His reportage informs and arms those emotions. At the same time, the same panoramic sweep of facts and analysis provides a useful source for rational understanding. The book is full of information, not caricature.

Bergen ranks among the more qualified individuals in the world to provide that reportage. In 1983 he filmed a documentary about Afghan refugees fleeing the Soviet invasion, and between 1990 and 1999 worked for CNN, focusing on the Middle East. In 1993 he travelled to Afghanistan to investigate the background of the bombing, that year, of the World Trade Center. Four years later, he produced the first televised interview with Osama bin Laden. He is now CNN's terrorism analyst. If in the course of all this he has developed any biases, they

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don't show too obviously; his book is an example of journalism at its best.

Although its publication date was moved up from the summer of 2002 because of the events of September 11, the book is not one of those "quickie" efforts rushed into print to exploit a surge of public feeling. The manuscript was finished and in to the publisher a month before the attacks. The few changes serve only to update it to the current situation.

Bergen gives a tapestry of factual detail about bin Laden himself, the al-Qaeda, the Taliban, radical Islamism as it exists in many societies, Islam as a religion, several specific individuals integral to the Islamist movement, and specifically about the many acts of terror against the United States and others during recent decades. Unless the book is to be replicated here, the best that can be done is to draw from it selectively to give attention to certain highlights:

1. Most Americans were shocked into awareness of the terror on September 11, but in fact a war had been underway against the United States for several years. A mob had burned down the United States' embassy in Pakistan in 1979. In 1983, 241 Marines died in the suicide truck bombing of their barracks in Lebanon. Rabbi Meir Kahane was assassinated by an Egyptian-American in Manhattan in 1990. The first World Trade Center bombing occurred in 1993, seeking a disaster even worse than that of September 11. Eighteen American soldiers were killed in Somalia in 1993, and Osama bin Laden claims his people had a hand in that. A United States facility was car-bombed in Riyadh in 1995. This was followed by the Khobar Towers bombing in 1996, killing 19 U.S. servicemen and injuring hundreds of others. In that year, Osama bin Laden made his first call for attacks against American military targets. He later dropped the distinction between military and civilian targets, so that the 1998 declaration announcing the formation of the "World Islamic Front for Jihad against the Jews and the Crusaders" called upon Muslims to "kill and fight Americans and their allies, whether civilian or military." The U.S. embassies in Kenya and Tanzania were bombed simultaneously in 1998, with massive casualties. On October 12, 2000, a hole was blown in the side of the USS Cole, killing 17 sailors and wounding 39 others. All along, there were foiled attempts that hardly received any public attention, such as the attempts in Yemen and New Delhi in June 2001.

This list is far from exhaustive; and other countries, not just the United States, have been targets, as anyone who remembers the slaughter of Israeli athletes at the 1972 Munich Olympics recalls. The Egyptian Jihad group, for example, has been at war with the Egyptian

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government for 25 years, and has been working closely with Osama bin Laden since the early 1990s.

2. Certain events have provided the "compact experience" that has triggered the radical Islamist movement. Of course, if we go back far enough, we see that the breaking up of the Ottoman Empire into a number of artificially constructed states at the end of World War I set the stage for much of what has since transpired in the Middle East. Among the results of that break-up were the British protectorate over Palestine, the eventual creation of the state of Israel after World War II, and the more than half-century of violence that has ensued between the Israelis and the Palestinians. That conflict, and the perceived continuing injustices to Palestinians, is one of the core stimuli for the radical Islamist movement.

As Bergen points out, 1979 was a seminal year. Among other things, the Ayatollah Khomeini overthrew the Shah in Iran, and the Soviet Union invaded Afghanistan in pursuit of the "Brezhnev Doctrine" that wouldn't permit a Communist regime to be overthrown. Thousands of Muslims trekked to Afghanistan to fight, becoming known as the "Afghan Arabs." This served much the same role for radical Islamism as the Spanish Civil War did, several decades before, for the world Left. It radicalized them, gave them military training and experience, and instilled solidarity.

For Osama bin Laden, 1991 was almost equally pivotal. He opposed Saddam Hussein in Iraq, whom he saw as not truly a Muslim leader; but he also took violent exception to the American presence in the Arabian peninsula, the "holiest place in Islam." That presence is now in its eleventh year.

3. The result is that there is now a radical Islamist movement committed to the methods of "asymmetrical warfare" in a great many countries. It is no longer dependent upon state sponsors, such as Syria, Iran and Libya. Its adherents come from diverse parts of Islam, and not simply from one fundamentalist sect. Hezbollah in Lebanon, for example, is Shia, whereas Osama bin Laden himself is a neo-fundamentalist Sunni.

What is perhaps of the highest importance is to realize that this is not coterminous with the vast world of Islam itself, even though it receives considerable sympathy from a great many Muslims. Islam is by no means a monolith; "there are as many Islams," Bergen says, "as there are Christianities." Many Islamic factions fight bitterly against other Islamic factions. The dominant political groups and governments within most countries "have their own reasons for cracking down on Islamist militant groups that threaten their security." The fact is, as Bergen tells

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us, that "most Middle Eastern governments are implacably opposed to al-Qaeda and its affiliates." At the same time, moderate Islam gained progressively in strength prior to September 11, except in Palestine.

The existence of major potential allies against radical Islamism within the Islamic world is, of course, a fact of the utmost significance in the on-going "war against terror." There is no reason to fight the billion or more Muslims the world over. As this is written, a debate is underway within the Bush administration and elsewhere between those (such as the 41 signers of the neo-conservative "open letter" in late September 2001 who would, in effect, have the United States go to war against all of Israel's enemies) and those who favor, instead, Secretary of State Powell's striving for an anti-terror coalition. Patrick Buchanan has written that "the final decision Bush makes will be as historically crucial as Truman's decision to let MacArthur advance to the Yalu, and FDR's decision to hold up Eisenhower's armies and let Stalin take Berlin."

4. Bergen believes that Osama bin Laden himself has little interest in the divide between the modern cosmopolitanism and secularism of the West and the culture of Islam. Political and religious factors are much more important to him: he funded the Afghan Arabs in their war against the Soviet Union in Afghanistan; opposes the presence of "infidels" in the Arabian peninsula; once called for a boycott against American goods because of the United States' support of Israel; and believes that the United States, through such interventions as the one in Somalia, is attempting to take over parts of the Islamic world.

5. This relates to Bergen's rejection of Samuel Huntington's "clash of civilizations" thesis. Bergen sees the on-going conflict as born out of such things as power politics and "the narcissism of minor differences," and not out of broad civilizational clashes. He points to the mutual slaughter among the Hutus and Tutsis, the clan warfare in Somalia, and the tribal conflict that has long plagued Afghanistan.

Bergen's point here is certainly to be taken seriously. He has much to cite to support his interpretation. We may be inclined, however, to think that Bergen's and Huntington's observations are not in fact mutually exclusive; they speak, rather, at a different level of generality. To say that nine distinct civilizations constitute self-assertive centers of power and belief, as Huntington does, is not to say that there are not, as well, many other sources of conflict. Those who would understand today's world will do well to read both *Holy War, Inc.*, and Huntington's *The Clash of Civilizations*.

Dwight D. Murphey

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Man
Between Past and Future

BRUNETTO CHIARELLI

University of Florence, Italy

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